

MID PENN BANCORP INC  
Form 10-Q  
November 09, 2009  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**

**FORM 10-Q**

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

**For the Quarterly Period Ended September 30, 2009**

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-13677

**MID PENN BANCORP, INC.**

**(Exact Name of Registrant as Specified in its Charter)**

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

**Pennsylvania**  
(State or Other Jurisdiction of

**25-1666413**  
(I.R.S. Employer Identification Number)

**Incorporation or Organization)**

**349 Union Street**

**Millersburg, Pennsylvania**  
(Address of Principal Executive Offices)

**17061**  
(Zip Code)

**(717) 692-2133**

**(Registrant's Telephone Number, Including Area Code)**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

As of November 9, 2009, there were 3,479,780 shares of the registrant's common stock outstanding, par value \$1.00 per share.

**Table of Contents**

**Index**

<b><u>PART I FINANCIAL INFORMATION</u></b>	2
<u>Item 1 Financial Statements</u>	2
<u>Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008 (Unaudited)</u>	2
<u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2009 and September 30, 2008 (Unaudited)</u>	3
<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2009 and September 30, 2008 (Unaudited)</u>	4
<u>Notes to Consolidated Financial Statements</u>	5
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>Item 3 Quantitative and Qualitative Disclosures about Market Risk</u>	25
<u>Item 4 Controls and Procedures</u>	25
<b><u>PART II OTHER INFORMATION</u></b>	25
<u>Item 1 Legal Proceedings</u>	25
<u>Item 1A Risk Factors</u>	25
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	25
<u>Item 3 Defaults upon Senior Securities</u>	25
<u>Item 4 Submission of Matters to a Vote of Security Holders</u>	26
<u>Item 5 Other Information</u>	26
<u>Item 6 Exhibits</u>	26
<u>Signatures</u>	28
<i>Unless the context otherwise requires, the terms "Mid Penn", "we", "us", and "our" refer to Mid Penn Bancorp, Inc. and its consolidated subsidiaries.</i>	

**Table of Contents****MID PENN BANCORP, INC.****Consolidated Balance Sheets (Unaudited)****PART I FINANCIAL INFORMATION****ITEM 1 Financial Statements**

(Dollars in thousands, except share data)	September 30, 2009	December 31, 2008
<b>ASSETS</b>		
Cash and due from banks	\$ 5,427	\$ 7,478
Interest-bearing balances with other financial institutions	392	970
Total cash and cash equivalents	5,819	8,448
Interest-bearing time deposits with other financial institutions	39,736	50,076
Available for sale investment securities	43,303	52,739
Loans and leases, net of unearned interest	484,709	434,643
Less: Allowance for loan and lease losses	(7,666)	(5,505)
Net loans and leases	477,043	429,138
Bank premises and equipment, net	12,164	11,377
Restricted investment in bank stocks	4,029	3,618
Foreclosed assets held for sale	388	1,516
Accrued interest receivable	2,692	2,747
Deferred income taxes	2,108	2,150
Goodwill	1,016	1,016
Core deposit and other intangibles, net	381	406
Cash surrender value of life insurance	7,298	7,437
Other assets	2,215	1,632
Total Assets	\$ 598,192	\$ 572,300
<b>LIABILITIES &amp; STOCKHOLDERS EQUITY</b>		
Deposits:		
Noninterest bearing demand	\$ 53,017	\$ 48,602
Interest bearing demand	39,209	39,048
Money Market	103,992	75,750
Savings	26,596	25,364
Time	248,602	248,060
Total Deposits	471,416	436,824
Short-term borrowings	24,856	23,977
Long-term debt	45,099	55,223
Accrued interest payable	2,994	2,411
Other liabilities	3,207	2,975
Total Liabilities	547,572	521,410
Stockholders Equity:		
Preferred stock, par value \$1,000; authorized 10,000,000 shares; 5% cumulative dividend; 10,000 shares issued and outstanding at September 30, 2009 and December 31, 2008	10,000	10,000
	3,480	3,480

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Common stock, par value \$1 per share; 10,000,000 shares authorized; 3,479,780 shares issued and outstanding at September 30, 2009 and December 31, 2008

Additional paid-in capital	29,828	29,838
Retained earnings	6,221	7,168
Accumulated other comprehensive income	1,091	404
Total Stockholders' Equity	50,620	50,890
Total Liabilities and Stockholders' Equity	\$ 598,192	\$ 572,300

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

**Table of Contents****MID PENN BANCORP, INC.****Consolidated Statements of Income (Unaudited)**

<b>(Dollars in thousands, except per share data)</b>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>INTEREST INCOME</b>				
Interest & fees on loans and leases	\$ 7,106	\$ 6,869	\$ 20,910	\$ 20,176
Interest on interest-bearing balances with financial institutions	337	592	1,177	1,961
Interest and dividends on investment securities:				
U.S. Treasury and government agencies	153	193	488	631
State and political subdivision obligations, tax-exempt	287	297	858	960
Other securities	3	35	10	121
Interest on federal funds sold and securities purchased under agreements to resell			1	
<b>Total Interest Income</b>	<b>7,886</b>	<b>7,986</b>	<b>23,444</b>	<b>23,849</b>
<b>INTEREST EXPENSE</b>				
Interest on deposits	2,577	2,841	8,088	8,623
Interest on short-term borrowings	40	132	99	557
Interest on long-term debt	599	721	1,900	2,030
<b>Total Interest Expense</b>	<b>3,216</b>	<b>3,694</b>	<b>10,087</b>	<b>11,210</b>
<b>Net Interest Income</b>	<b>4,670</b>	<b>4,292</b>	<b>13,357</b>	<b>12,639</b>
<b>PROVISION FOR LOAN AND LEASE LOSSES</b>	<b>1,108</b>	<b>275</b>	<b>2,520</b>	<b>530</b>
<b>Net Interest Income After Provision for Loan and Lease Losses</b>	<b>3,562</b>	<b>4,017</b>	<b>10,837</b>	<b>12,109</b>
<b>NONINTEREST INCOME</b>				
Trust department income	61	69	184	204
Service charges on deposits	382	455	1,119	1,303
Earnings from cash surrender value of life insurance	80	65	220	192
Gain on life insurance proceeds			158	
Mortgage banking income	37	11	72	49
Other income	349	398	958	1,052
<b>Total Noninterest Income</b>	<b>909</b>	<b>998</b>	<b>2,711</b>	<b>2,800</b>
<b>NONINTEREST EXPENSE</b>				
Salaries and employee benefits	2,102	1,832	6,224	5,428
Occupancy expense, net	225	227	661	754
Equipment expense	304	208	848	634
Pennsylvania Bank Shares tax expense	100	93	301	277
FDIC Assessment	347	12	871	45
Legal and professional fees	126	223	479	544
Director fees and benefits expense	83	77	225	245
Marketing and advertising expense	145	155	606	337
Computer expense	109	135	332	383
Stationery and supplies expense	31	61	110	188
Loss on sale / write-down of foreclosed assets	40		76	32
Other expenses	618	502	1,706	1,581
<b>Total Noninterest Expense</b>	<b>4,230</b>	<b>3,525</b>	<b>12,439</b>	<b>10,448</b>
<b>INCOME BEFORE PROVISION FOR (BENEFIT FROM) INCOME TAXES</b>	<b>241</b>	<b>1,490</b>	<b>1,109</b>	<b>4,461</b>

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Provision for (benefit from) income taxes	(93)	368	(151)	1,106
NET INCOME	334	1,122	1,260	3,355
Preferred stock dividends and discount accretion	128		385	
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$ 206	\$ 1,122	\$ 875	\$ 3,355
PER COMMON SHARE DATA:				
Basic Earnings Per Common Share	\$ 0.06	\$ 0.32	\$ 0.25	\$ 0.96
Diluted Earnings Per Common Share	\$ 0.06	\$ 0.32	\$ 0.25	\$ 0.96
Cash Dividends Declared	\$ 0.16	\$ 0.20	\$ 0.52	\$ 0.60

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

**Table of Contents****MID PENN BANCORP, INC.****Consolidated Statements of Cash Flows (Unaudited)**

<b>(Dollars in thousands)</b>	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Operating Activities:</b>		
Net Income	\$ 1,260	\$ 3,355
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	2,520	530
Depreciation	816	625
Amortization (accretion) of core deposit intangible	25	(58)
Net amortization (accretion) of securities premiums (discounts)	66	(8)
Earnings on cash surrender value of life insurance	(220)	(399)
Gain from life insurance proceeds	(158)	
Loss on disposal of property, plant, and equipment	5	
Loss on sale / write-down of foreclosed assets	76	32
Deferred income tax benefit	(155)	(7)
Decrease in accrued interest receivable	55	75
(Increase) decrease in other assets	(593)	449
Increase in accrued interest payable	583	1,324
Increase in other liabilities	162	393
<b>Net Cash Provided by Operating Activities</b>	<b>4,442</b>	<b>6,311</b>
<b>Investing Activities:</b>		
Net (increase) decrease in interest-bearing time deposits	10,340	(2,621)
Proceeds from the maturity of investment securities	13,647	17,238
Purchases of investment securities	(3,393)	(7,791)
Purchase of restricted investment in bank stock	(411)	(3,617)
Net increase in loans and leases	(50,563)	(48,504)
Purchases of bank premises and equipment	(1,608)	(1,070)
Proceeds from sale of foreclosed assets	1,190	52
Proceeds from cash surrender value of life insurance	517	
<b>Net Cash Used in Investing Activities</b>	<b>(30,281)</b>	<b>(46,313)</b>
<b>Financing Activities:</b>		
Net increase in demand deposits and savings accounts	34,050	33,581
Net increase in time deposits	542	11,499
Net increase (decrease) in short-term borrowings	879	(5,351)
Preferred stock dividend paid	(328)	
Common stock dividend paid	(1,809)	(2,091)
Long-term debt repayment	(10,124)	(15,113)
Purchase of treasury stock		(253)
Proceeds from long-term debt		15,795
<b>Net Cash Provided by Financing Activities</b>	<b>23,210</b>	<b>38,067</b>
Net decrease in cash and cash equivalents	(2,629)	(1,935)
Cash and cash equivalents, beginning of period	8,448	10,616
Cash and cash equivalents, end of period	\$ 5,819	\$ 8,681
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Interest paid	\$ 9,504	\$ 9,886



Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Income taxes paid			1,295
Supplemental Noncash Disclosures:			
Transfers to foreclosed assets held for sale	\$	138	\$ 929

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

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****1. Basis of Presentation**

The consolidated financial statements for 2009 and 2008 include the accounts of Mid Penn Bancorp, Inc. ( Mid Penn ), and its subsidiaries Mid Penn Bank (the Bank ), Mid Penn Insurance Services, LLC, and Mid Penn Investment Corporation (collectively the Corporation ). All material intercompany accounts and transactions have been eliminated in consolidation.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). We believe the information presented is not misleading and the disclosures are adequate. For comparative purposes, the September 30, 2008 balances have been reclassified to conform to the 2009 presentation. Such reclassifications had no impact on net income. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year. These interim consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in Mid Penn s Annual Report on Form 10-K for the year ended December 31, 2008, and with Mid Penn s Forms 8-K, that were filed during 2009 with the SEC.

The Corporation has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2009, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through November 9, 2009, the date these consolidated financial statements were issued.

**2. Short-term Borrowings**

Short-term borrowings as of September 30, 2009 and December 31, 2008 consisted of:

(Dollars in thousands)	September 30, 2009	December 31, 2008
Federal funds purchased	\$ 20,384	\$ 17,920
Securities sold under repurchase agreements	4,030	5,041
Treasury, tax and loan notes	442	1,016
	\$ 24,856	\$ 23,977

Federal funds purchased represent overnight funds. Securities sold under repurchase agreements generally mature between one day and one year. Treasury tax and loan notes are open-ended interest bearing notes payable to the U.S. Treasury upon call. All tax deposits accepted by the Bank are placed in the Treasury note option account.

**3. Long-term Debt**

During the three months and nine months ended September 30, 2009, the Bank entered into no additional long-term borrowings with the Federal Home Loan Bank of Pittsburgh. During the three months ended September 30, 2009, the Bank did not pay down any long-term debt. The Bank has paid down long-term debt by \$10 million during the nine months ended September 30, 2009.

**4. Defined Benefit Plans**

Mid Penn has an unfunded noncontributory defined benefit retirement plan for directors. The plan provides defined benefits based on years of service. In addition, Mid Penn sponsors a defined benefit health care plan that provides post-retirement medical benefits and life insurance to full-time employees. These health care and life insurance plans are noncontributory. A December 31 measurement date for our plans is used.

**Table of Contents**

MID PENN BANCORP, INC.

Notes to Consolidated Financial Statements

The components of net periodic benefit costs from these benefit plans are as follows:

(Dollars in thousands)	Three Months Ended September 30,			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Service cost	\$ 5	\$ 6	\$ 4	\$ 12
Interest cost	14	15	8	9
Amortization of transition obligation				4
Amortization of prior service cost	5	5		
Amortization of net gain			(3)	(1)
Net periodic benefit cost	\$ 24	\$ 26	\$ 9	\$ 24

(Dollars in thousands)	Nine Months Ended September 30,			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Service cost	\$ 15	\$ 18	\$ 12	\$ 36
Interest cost	42	45	24	27
Amortization of transition obligation				12
Amortization of prior service cost	15	15		
Amortization of net gain			(9)	(3)
Net periodic benefit cost	\$ 72	\$ 78	\$ 27	\$ 72

**5. Earnings per Common Share**

Earnings per common share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each of the periods presented giving retroactive effect to stock dividends and stock splits. The following data show the amounts used in computing basic and diluted earnings per common share. As shown in the table that follows, diluted earnings per common share is computed using weighted average common shares outstanding, plus weighted average common shares available from the exercise of all dilutive stock warrants issued to the U.S. Treasury under the provisions of the Capital Purchase Program, based on the average share price of Mid Penn's common stock during the period.

The computations of basic earnings per common share follow:

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net Income	\$ 334	\$ 1,122	\$ 1,260	\$ 3,355
Less: Dividends on preferred stock	(125)		(375)	
Accretion of preferred stock discount	(3)		(10)	
Net income available to common stockholders	\$ 206	\$ 1,122	\$ 875	\$ 3,355
Weighted average common shares outstanding	3,479,780	3,479,780	3,479,780	3,484,210
Basic earnings per common share	\$ 0.06	\$ 0.32	\$ 0.25	\$ 0.96
The computations of diluted earnings per common share follow:				

(Dollars in thousands, except per share data)

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income available to common stockholders	\$ 206	\$ 1,122	\$ 875	\$ 3,355
Weighted average number of common shares outstanding	3,479,780	3,479,780	3,479,780	3,484,210
Dilutive effect of potential common stock arising from stock warrants:				
Exercise of outstanding stock warrants issued to U.S. Treasury under the Capital Repurchase Program				
Adjusted weighted-average common shares outstanding	3,479,780	3,479,780	3,479,780	3,484,210
Diluted earnings per common share	\$ 0.06	\$ 0.32	\$ 0.25	\$ 0.96

**Table of Contents**

MID PENN BANCORP, INC.

Notes to Consolidated Financial Statements

**6. Comprehensive Income (Loss)**

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains, and losses be included in net income. Changes in certain assets and liabilities such as unrealized gains (losses) on securities available for sale and the liability associated with defined benefit plans, are reported as a separate component of the stockholders' equity section of the balance sheet. Such items, along with net income, are components of comprehensive income (loss). The components of other comprehensive income (loss), and the related tax effects, are as follows:

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Change in unrealized holding gains (losses) on available for sale securities	\$ 1,373	\$ (368)	\$ 884	\$ (725)
Less reclassification adjustment for gains realized in income		(8)		(8)
Net unrealized gains (losses)	1,373	(376)	884	(733)
Change in defined benefit plans	3		158	
Other comprehensive income (loss)	1,376	(376)	1,042	(733)
Income tax effect	(468)	128	(355)	249
Net of tax amount	\$ 908	\$ (248)	\$ 687	\$ (484)

**7. Guarantees**

In the normal course of business, Mid Penn makes various commitments and incurs certain contingent liabilities, which are not reflected in the accompanying consolidated financial statements. The commitments include various guarantees and commitments to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Mid Penn evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Standby letters of credit and financial guarantees written are conditional commitments to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Mid Penn had \$11,072,000 and \$10,517,000 of standby letters of credit outstanding as of September 30, 2009 and December 31, 2008, respectively. The Corporation does not anticipate any losses because of these transactions. The current amount of the liability as of September 30, 2009 for payment under standby letters of credit issued was not material.

**8. Split Dollar Life Insurance Postretirement Benefits**

GAAP requires Split-Dollar Life Insurance Arrangements to have a liability recognized related to the postretirement benefits covered by an endorsement split-dollar life insurance arrangement, and a liability for the future death benefit. Mid Penn recorded a cumulative effect adjustment to the balance of retained earnings of \$277,000 as of January 1, 2008.

**9. Fair Value Measurements**

Mid Penn adopted Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements and Disclosures effective January 1, 2008 for financial assets and financial liabilities and on January 1, 2009, for non-financial assets and non-financial liabilities. This guidance defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements.

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. This guidance provides additional information on determining when the volume and level of activity for the asset or liability has significantly decreased. The guidance also includes information on identifying circumstances when a transaction may not be considered orderly.

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

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements**

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

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own belief about the assumptions market participants would use in pricing the asset or liability based upon the best information available in the circumstances. Fair value measurement and disclosure guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

**Level 2 Inputs** Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability;

**Level 3 Inputs** Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of Mid Penn's financial assets and financial liabilities carried at fair value effective January 1, 2008.

The following table illustrates the financial instruments measured at fair value on a recurring basis segregated by hierarchy fair value levels:

(Dollars in thousands)	Total carrying value at September 30, 2009	Fair value measurements at September 30, 2009 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Securities available for sale	\$ 43,303		\$ 43,303	

(Dollars in thousands)	Total carrying value at December 31, 2008	Fair value measurements at December 31, 2008 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Securities available for sale	\$ 52,739		\$ 52,739	

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

**Table of Contents**

MID PENN BANCORP, INC.

Notes to Consolidated Financial Statements

The following table illustrates the financial instruments measured at fair value on a nonrecurring basis segregated by hierarchy fair value levels:

(Dollars in thousands)	Total carrying value at September 30, 2009	Fair value measurements at September 30, 2009 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets:</b>				
Impaired Loans	\$ 10,168			\$ 10,168
Foreclosed Assets	388			388

  

(Dollars in thousands)	Total carrying value at December 31, 2008	Fair value measurements at December 31, 2008 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets:</b>				
Impaired Loans	\$ 5,492			\$ 5,492
Foreclosed Assets	1,516			1,516

ASC Topic 825, Financial Instruments, requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements.

The following methodologies and assumptions were used to estimate the fair value of Mid Penn's financial instruments:

**Cash and Cash Equivalents:**

The carrying value of cash and cash equivalents is considered to be a reasonable estimate of fair value.

**Interest-bearing Balances with other Financial Institutions:**

The estimate of fair value was determined by comparing the present value of quoted interest rates on like deposits with the weighted average yield and weighted average maturity of the balances.

**Securities Available for Sale:**

Securities classified as available for sale are generally reported at fair value utilizing Level 2 inputs. For these securities, we obtain fair value measurements from an independent pricing service. These valuation services estimate fair value using pricing models and other accepted valuation methodologies, such as quotes for similar securities and observable yield curves and spreads.

**Impaired Loans:**

Certain loans are evaluated for impairment using the practical expedients including impaired loans measured at an observable market price (if available), or at the fair value of the loan's collateral (if the loan is collateral dependent). The value of the collateral is determined through appraisals performed by independent licensed appraisers. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Mid Penn considers the appraisals used in its impairment analysis to be Level 3 inputs. Impaired loans are reviewed and evaluated as needed for additional impairment, and reserves are adjusted accordingly.

**Loans:**

For variable-rate loans that reprice frequently and which entail no significant changes in credit risk, carrying values approximated fair value. Substantially all commercial loans and real estate mortgages are variable rate loans. The fair value of other loans (i.e. consumer loans and fixed-rate real estate mortgages) are estimated by calculating the present value of the cash flow difference between the current rate and the market rate, for the average maturity, discounted quarterly at the market rate.



***Foreclosed Assets:***

Assets included in foreclosed assets held for sale are carried at the lower of cost or fair value and accordingly is presented as measured on a non-recurring basis. Values are estimated using Level 3 inputs, based on appraisals that consider the sales prices of property in the proximate vicinity.

***Accrued Interest Receivable and Payable:***

The carrying amount of accrued interest receivable and payable approximates their fair values.

***Restricted Investment in Bank Stocks:***

The carrying amount of required and restricted investment in correspondent bank stock approximates fair value, and considers the limited marketability of such securities.

***Deposits:***

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements**

The fair value for demand deposits (e.g., interest and noninterest checking, savings and money market deposit accounts) are by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). Fair value for fixed-rate certificates of deposit was estimated using a discounted cash flow calculation by combining all fixed-rate certificates into a pool with a weighted average yield and a weighted average maturity for the pool and comparing the pool with interest rates currently being offered on a similar maturity.

**Short-term Borrowings:**

Because of time to maturity, the estimated fair value of short-term borrowings approximates the book value.

**Long-term Debt:**

The estimated fair values of long-term debt were determined using discounted cash flow analysis, based on currently available borrowing rates for similar types of borrowing arrangements.

**Commitments to Extend Credit and Letters of Credit:**

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms and present credit worthiness of the counterparties. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements.

The following table summarizes the carrying value and fair value of financial instruments at September 30, 2009 and December 31, 2008.

(Dollars in thousands)	September 30, 2009		December 31, 2008	
	Book Value	Fair Value	Book Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 5,819	\$ 5,819	\$ 8,448	\$ 8,448
Interest-bearing balances with other financial institutions	39,736	39,736	50,076	50,076
Investment securities	43,303	43,303	52,739	52,739
Net loans and leases	477,043	495,486	429,138	456,323
Restricted investment in bank stocks	4,029	4,029	3,618	3,618
Accrued interest receivable	2,692	2,692	2,747	2,747
<b>Financial liabilities:</b>				
Deposits	\$ 471,416	\$ 480,067	\$ 436,824	\$ 447,482
Short-term borrowing	24,856	24,856	23,977	23,977
Long-term debt	45,099	47,549	55,223	58,721
Accrued interest payable	2,994	2,994	2,411	2,411
<b>Off-balance sheet financial instruments:</b>				
Commitments to extend credit	\$	\$	\$	\$
Financial standby letters of credit				

**10. Preferred Stock**

On December 19, 2008, MPB entered into, and closed, a Letter Agreement with the United States Department of the Treasury (the Treasury) pursuant to which the Treasury invested \$10,000,000 in the Corporation under the Treasury's Capital Purchase Program (the CPP).

Under the CPP, the Treasury received (1) 10,000 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock, \$1,000 liquidation preference, and (2) Warrants to purchase up to 73,099 shares of the Corporation's common stock at an exercise price of \$20.52 per share. The \$10,000,000 in new capital is treated as Tier 1 Capital.

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

The Series A Preferred Stock pays cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. Pursuant to the American Recovery and Reinvestment Act of 2009, the Secretary of the Treasury shall permit, subject to consultation with the appropriate Federal banking agency, the Corporation to redeem the Series A Preferred Stock. The Corporation may do so without regard to the source of the funds to be used to redeem the Series A Preferred Stock or any minimum waiting period. If the Corporation elects to redeem the Series A Preferred Stock prior to February 15, 2012, and receives approval from the Treasury and the Board of Governors of the Federal Reserve System, it must redeem at least \$2,500,000 of the Series A Preferred Stock. Upon redemption of the Series A Preferred Stock, the Secretary of the Treasury shall liquidate the warrants associated with the Corporation's participation in the CPP at the current market price. Upon the appropriate approval, the Corporation may

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements**

redeem the Series A Preferred Stock at the original purchase price plus accrued but unpaid dividends, if any. The related Warrants expire in ten years and are immediately exercisable upon their issuance.

To participate in the program, the Corporation is required to meet certain standards, including: (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risk that threatens the value of the Corporation; (2) requiring a clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibiting the Corporation from making any golden parachute payment to a senior executive based on applicable Internal Revenue Code provisions; and (4) agreeing not to deduct, for tax purposes, executive compensation in excess of \$500,000 for each senior executive.

Based on the Program term sheet provided by the Treasury, the following would be the effects on holders of common stock from the issuance of Senior Preferred stock to the Treasury under the Program:

***Restrictions on Dividends***

For as long as any Senior Preferred shares are outstanding, no dividends could be declared or paid on common shares, nor could the Corporation repurchase or redeem any common shares, unless all accrued and unpaid dividends for all past dividend periods on the Senior Preferred shares had been fully paid. In addition, the consent of the Treasury would be required for any increase in the per share dividends on common shares until the third anniversary of the date of the Senior Preferred investment unless prior to such third anniversary, the Senior Preferred shares were redeemed in whole or the Treasury had transferred all of the Senior Preferred shares to third parties.

***Repurchases***

The Treasury's consent would be required for any share repurchases (other than (1) repurchases of the Senior Preferred shares and (2) repurchases of common shares in connection with any benefit plan in the ordinary course of business consistent with past practice) until the third anniversary of the date of this investment unless prior to such third anniversary the Senior Preferred shares had been redeemed in whole or the Treasury had transferred all of the Senior Preferred shares to third parties. In addition, there could be no share repurchases of common shares if prohibited as described under *Restrictions on Dividends* above.

***Voting Rights***

The Senior Preferred shares would be non-voting, other than class voting rights on (1) any authorization or issuance of shares ranking senior to the Senior Preferred shares, (2) any amendment to the rights of senior Preferred, or (3) any merger, exchange or similar transaction which would adversely affect the rights of the Senior Preferred. If dividends on the Senior Preferred shares were not paid in full for six dividend periods, whether or not consecutive, the Senior Preferred shareholder(s) would have the right to elect two directors. The right to elect directors would end when full dividends had been paid for four consecutive dividend periods.

**11. Investment Securities**

Securities to be held for indefinite periods, but not intended to be held to maturity, are classified as available for sale and carried at fair value. Securities held for indefinite periods include securities that management intends to use as part of its asset and liability management strategy and that may be sold in response to changes in interest rates, resultant prepayment risk, and other factors related to interest rate and resultant prepayment risk changes.

Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value of the securities sold, using the specific identification method. Unrealized gains and losses on investment securities available for sale are based on the difference between book value and fair value of each security. These gains and losses are credited or charged to other comprehensive income, whereas realized gains and losses flow through the Corporation's results of operations.

ASC Topic 320, *Investments—Debt and Equity Securities*, clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. Previously, this assessment required management to assert it has both

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in fair value to avoid recognizing an other-than-temporary impairment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price.

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

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements**

than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

At September 30, 2009 and December 31, 2008, amortized cost, fair value, and unrealized gains and losses on investment securities are as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2009				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 10,795	\$ 491	\$	\$ 11,286
Mortgage-backed U.S. government agencies	4,826	127		4,953
State and political subdivision obligations	25,710	1,129	21	26,818
Equity securities	250		4	246
	\$ 41,581	\$ 1,747	\$ 25	\$ 43,303

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2008				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 22,347	\$ 739	\$	\$ 23,086
Mortgage-backed U.S. government agencies	4,154	25	6	4,173
State and political subdivision obligations	25,151	566	473	25,244
Equity securities	250		14	236
	\$ 51,902	\$ 1,330	\$ 493	\$ 52,739

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements**

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2009 and December 31, 2008.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>(Dollars in thousands)</b>						
September 30, 2009						
Available-for-sale securities:						
U.S. Treasury and U.S. government agencies	\$	\$	\$	\$	\$	\$
Mortgage-backed U.S. government agencies						
State and political subdivision obligations			1,615	21	1,615	21
Equity securities			246	4	246	4
Total temporarily impaired available-for-sale securities	\$	\$	\$ 1,861	\$ 25	\$ 1,861	\$ 25

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>(Dollars in thousands)</b>						
December 31, 2008						
Available-for-sale securities:						
U.S. Treasury and U.S. government agencies	\$	\$	\$	\$	\$	\$
Mortgage-backed U.S. government agencies	1,400	6			1,400	6
State and political subdivision obligations	5,520	293	2,098	180	7,618	473
Equity securities			236	14	236	14
Total temporarily impaired available-for-sale securities	\$ 6,920	\$ 299	\$ 2,334	\$ 194	\$ 9,254	\$ 493

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis; and more frequently when economic or market 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, and (3) the intent and ability of Mid Penn to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At September 30, 2009, Mid Penn had 4 debt securities with unrealized losses. These securities have depreciated 1.08% from their amortized cost basis. At December 31, 2008, the 21 debt securities with unrealized losses had depreciated 5.05% from their amortized cost basis. These securities are issued by either the U.S. Government or other governmental agencies. These unrealized losses were determined principally by reference to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the U.S. Government or its agencies issued the securities, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future, no declines are deemed to be other than temporary.

The following is a schedule of the maturity distribution of investment securities at amortized cost and fair value at September 30, 2009 and December 31, 2008:

	September 30, 2009		December 31, 2008	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<b>(Dollars in thousands)</b>				

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Due in 1 year or less	\$ 544	\$ 550	\$ 11,643	\$ 11,671
Due after 1 year but within 5 years	8,257	8,518	9,053	9,378
Due after 5 years but within 10 years	16,904	17,776	18,106	18,929
Due after 10 years	10,800	11,260	8,696	8,352
	36,505	38,104	47,498	48,330
Mortgage-backed securities (avg. life 1.6 years)	4,826	4,953	4,154	4,173
Equity securities	250	246	250	236
	\$ 41,581	\$ 43,303	\$ 51,902	\$ 52,739



**Table of Contents**

MID PENN BANCORP, INC.

Notes to Consolidated Financial Statements

**12. Recent Accounting Pronouncements****FASB Statement No. 168**

In June 2009, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 168, *The FASB Accounting Standards Codification*<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162, ( SFAS 168 ). SFAS 168 establishes the *FASB Accounting Standards Codification*<sup>TM</sup> ( Codification ) as the source of authoritative generally accepted accounting principles ( GAAP ) for nongovernmental entities. The Codification does not change GAAP. Instead, it takes the thousands of individual pronouncements the currently comprise GAAP and reorganizes them approximately 90 accounting Topics, and displays all Topics using a consistent structure. Contents in each Topic are further organized first by Subtopic, then Section and finally Paragraph. The Paragraph level is the only level that contains substantive content. Citing particular content in the Codification involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure. FASB suggests that all citations begin with FASB ASC, where ASC stands for *Accounting Standards Codification*. Changes to the ASC subsequent to June 30, 2009 are referring to as Accounting Standards Updates ( ASU ).

In conjunction with the issuance of SFAS 168, the FASB also issued its first Accounting Standards Update No. 2009-1, Topic 105 Generally Accepted Accounting Principles ( ASU 2009-1 ) which includes SFAS 168 in its entirety as a transition to the ASC. ASU 2009-1 is effective for interim and annual periods ending after September 15, 2009 and will not have an impact on the Corporation's financial position or results of operations but will change the referencing system for accounting standards.

**ASU 2009-05**

In August 2009, the FASB issued ASU 2009-05, *Fair Value Measurements and Disclosures (Topic 820): Measuring Liabilities at Fair Value*. The amendments within ASU 2009-05 clarify that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques:

A valuation technique that uses:

- a. The quoted price of the identical liability when traded as an asset.
- b. Quoted prices for similar liabilities or similar liabilities when traded as assets.

Another valuation technique that is consistent with the principles of Topic 820.

Two examples would be an income approach, such as a present value technique, or a market approach, such as a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer the identical liability or would receive to enter into the identical liability.

When estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability.

Both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements.

This guidance is effective for the first reporting period (including interim periods) beginning after issuance. The Corporation is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

**13. Subsequent Event**

During October of 2009, an additional \$992,000 in recommended partial and full loan charge offs on 20 credits was presented and approved by the Board of Directors. The full charge offs represent loans on which any collectability is not expected and where collateral is not present or of insufficient value to offset the outstanding loan balance. The partial charge off recommendations represent loans on which collateral value is

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

insufficient to cover all of the outstanding loan balance, however management's collection efforts have resulted in continuing payments on the loans. In the event that the borrower's financial condition improves, resulting in full repayment of the outstanding debt, MPB will record a recovery of the charged off portion.

At September 30, 2009, the allowance for loan and lease losses contained specific reserves totaling \$966,000 against this pool of loans being recommended for charge off. Any remaining balances on the loans partially charged off will remain rated as classified loans.

**Table of Contents**

**MID PENN BANCORP, INC.**

**Management's Discussion and Analysis**

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

The following is Management's Discussion of Consolidated Financial Condition as of September 30, 2009, compared to year-end 2008 and the Results of Operations for the three and nine months ended September 30, 2009, compared to the same periods in 2008.

This discussion should be read in conjunction with the financial tables, statistics, and the audited financial statements and notes thereto included in Mid Penn's Annual Report on Form 10-K for the year ended December 31, 2008, Mid Penn's Quarterly Reports on Form 10-Q filed during 2009, and with Mid Penn's Forms 8-K, that were filed during 2009 with the SEC. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year.

Certain of the matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations, may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Corporation to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words expect, anticipates, intend, plan, believe, estimate, and similar expressions are intended to identify such forward-looking statements.

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

The effects of future economic conditions on Mid Penn and its customers;

Governmental monetary and fiscal policies, as well as legislative and regulatory changes;

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters;

The risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;

The effects of economic deterioration on current customers, specifically the effect of the economy on loan customers' ability to repay loans;

The effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in Mid Penn's market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;

The costs and effects of litigation and of unexpected or adverse outcomes in such litigation;

Technological changes;

Acquisitions and integration of acquired businesses;

The failure of assumptions underlying the establishment of reserves for loan and lease losses and estimations of values of collateral and various financial assets and liabilities;

Acts of war or terrorism;

Volatilities in the securities markets;

Deteriorating economic conditions.

Mid Penn undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review the risk factors described in the Annual Report and other documents that we periodically file with the SEC, including Mid Penn's Annual Report on Form 10-K for the year ended December 31, 2008.

### ***Critical Accounting Estimates***

Mid Penn's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. Application of these principles involves significant judgments and estimates by management that have a material impact on the carrying value of certain assets and liabilities. The judgments and estimates that we used are based on historical experiences and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and estimates that we have made, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations.

Management of the Corporation considers the accounting judgments relating to the allowance for loan and lease losses and the evaluation of the Corporation's investment securities for other-than-temporary impairment to be the accounting areas that require the most subjective and complex judgments.

The allowance for loan and lease losses represents management's estimate of potentially incurred credit losses inherent in the loan and lease portfolio. Determining the amount of the allowance for loan and lease losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan and lease portfolio also represents the largest asset type on the consolidated balance sheet. Throughout the remainder of this report, the terms "loan" or "loans" refers to both loans and leases.

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis**

Valuations for the investment portfolio are determined using quoted market prices, where available. If quoted market prices are not available, investment valuation is based on pricing models, quotes for similar investment securities, and observable yield curves and spreads. In addition to valuation, management must assess whether there are any declines in value below the carrying value of the investments that should be considered other than temporary or otherwise require an adjustment in carrying value and recognition of the loss in the consolidated statement of income.

**Results of Operations***Overview*

Net income available to common stockholders was \$206,000 or \$0.06 per common share for the quarter ended September 30, 2009, as compared to net income available to common stockholders of \$1,122,000 or \$0.32 per common share for the quarter ended September 30, 2008. During the nine months ended September 30, 2009, net income available to common stockholders was \$875,000 or \$0.25 per common share versus \$3,355,000 or \$0.96 per common share during the same period in 2008. Net income available to common stockholders was adversely impacted by increased FDIC assessments, higher levels of provision for loan and lease losses, and other increased noninterest expenses as more fully explained below.

The net interest margin compression experienced throughout 2008 has begun to abate somewhat in 2009 with net interest income increasing to \$4,670,000 in the three months ended September 30, 2009 from \$4,292,000 during the same period in 2008. The nine months ended September 30, 2009 reflect an increasing level of net interest income as well, growing to \$13,357,000 versus \$12,639,000 during the same period in 2008. These increases have been spurred by a moderating cost of funds and increasing levels of average earning assets.

The provision for loan and lease losses in the third quarter of 2009 was \$1,108,000, as compared to \$275,000 in the third quarter of 2008. During the nine months ended September 30, 2009, the provision for loan and lease losses was \$2,520,000 compared to \$530,000 for the nine months ended September 30, 2008. The increased provision reflects strong loan volume growth, weak economic conditions, and additional legacy loan issues.

Increasing noninterest expenses in the three and nine months ended September 30, 2009, versus the same periods in 2008, also negatively affected earnings. The three primary areas of increased expenses during these periods were Salaries and Benefits, FDIC Assessment, and Marketing and Advertising expense.

Net income as a percent of average assets (return on average assets or ROA) and stockholders' equity (return on average equity or ROE) were as follows on an annualized basis:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Return on average assets	0.23%	0.82%	0.29%	0.84%
Return on average equity	2.64%	11.10%	3.23%	11.09%

Total assets increased to \$598,192,000 at September 30, 2009, from \$572,300,000 on December 31, 2008. This asset increase was the result of strong loan demand to this point of 2009 with gross loans of \$484,709,000 at September 30, 2009 compared to \$434,643,000 at year-end, an increase of approximately \$50 million. This growth in loans and leases was funded by maturities or calls of interest-bearing time deposits with other financial institutions and investment securities as well as an aggressive push on the generation of core deposit accounts within MPB's market area.

The funding side of Mid Penn has undergone a dramatic transformation since December 31, 2008. Deposit growth was strong during the first nine months of 2009. Total deposits were \$471,416,000 at September 30, 2009, compared to \$436,824,000 at December 31, 2008, an increase of approximately \$35 million. This increase in deposits was primarily caused by a flight to safety as investors retreat from the stock market and invest funds in insured accounts. Not clearly evident from these numbers is the transformation in deposit composition Mid Penn has experienced. During the first nine months of 2009, \$10,000,000 of brokered deposits have matured and been replaced with local, core deposits. In addition, \$10,000,000 of long-term FHLB debt has matured and been shifted into overnight borrowings at very advantageous rates. These strategies have improved cost of funds and energized the net interest margin despite increasing levels of nonaccrual loans. Mid Penn continued,

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

during the third quarter of 2009, an aggressive campaign of soliciting traditional, relationship-based, core deposit accounts from new and existing customers to replace wholesale funding sources and reduce the bank's reliance on higher costing time deposits.

### *Net Interest Income/Funding Sources*

Net interest income, Mid Penn's primary source of revenue, is the amount by which interest income on loans and investments exceeds interest incurred on deposits and borrowings. The amount of net interest income is affected by changes in interest rates and changes in the volume and mix of interest-sensitive assets and liabilities. Net interest income and corresponding yields are presented in the analysis below on a taxable-equivalent basis. Income from tax-exempt assets, primarily loans to or securities issued by state and local governments, is adjusted by an amount equivalent to the federal income taxes which would have been paid if the income received on these assets was taxable at the statutory rate of 34%. The following table includes average balances, rates, interest income and expense, interest rate spread, and net interest margin:

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis**

(Dollars in thousands)	For the Nine Months Ended September 30, 2009			For the Nine Months Ended September 30, 2008		
	Balance	Interest	Rate (%)	Balance	Interest	Rate (%)
<b>ASSETS:</b>						
Interest Earning Assets						
Interest Earning Balances	\$ 42,554	\$ 1,177	3.70%	\$ 56,211	\$ 1,961	4.66%
Investment Securities:						
Taxable	19,273	495	3.43%	21,582	640	3.96%
Tax-Exempt	25,122	1,303	6.93%	27,990	1,454	6.94%
Total Investment Securities	44,395			49,572		
Federal Funds Sold	343	1	0.39%			
Loans and Leases, Net:						
Taxable	443,506	20,433	6.16%	387,194	19,877	6.86%
Tax-Exempt	13,551	723	7.13%	8,487	453	7.13%
Total Loans and Leases, Net	457,057			395,681		
Restricted Investment in Bank Stocks	3,895	1	0.03%	1,908	112	7.84%
Total Earning Assets	548,244	24,133	5.89%	503,372	24,497	6.50%
Cash and Due from Banks	6,596			7,826		
Other Assets	22,370			21,717		
Total Assets	\$ 577,210			\$ 532,915		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY:</b>						
Interest Bearing Liabilities						
Interest Bearing Deposits:						
NOW	\$ 37,423	25	0.09%	\$ 36,265	86	0.32%
Money Market	81,587	964	1.58%	67,592	1,063	2.10%
Savings	26,330	14	0.07%	25,749	50	0.26%
Time	251,769	7,085	3.76%	227,488	7,424	4.36%
Short-term Borrowings	23,167	99	0.57%	30,533	557	2.44%
Long-term Debt	48,640	1,900	5.22%	52,038	2,030	5.21%
Total Interest Bearing Liabilities	468,916	10,087	2.88%	439,665	11,210	3.41%
Demand Deposits	50,226			46,571		
Other Liabilities	5,856			6,252		
Stockholders' Equity	52,212			40,427		
Total Liabilities and Stockholders' Equity	\$ 577,210			\$ 532,915		
Net Interest Income		\$ 14,046		\$ 13,287		
<b>Net Yield on Interest Earning Assets:</b>						
Total Yield on Earning Assets			5.89%			6.50%
Rate on Supporting Liabilities			2.88%			3.41%
Average Interest Spread			3.01%			3.09%
Net Interest Margin			3.43%			3.53%

For the nine months ended September 30, 2009, Mid Penn's taxable-equivalent net interest margin declined to 3.43% from 3.53% as compared to the nine months ended September 30, 2008, driven primarily by a reduction in market interest rates and the tightening spread between the yield

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

on earning assets and the cost of supporting liabilities. Net interest income, on a taxable-equivalent basis, in the first nine months of 2009 increased to \$14,046,000 from \$13,287,000 in the first nine months of 2008, helped by the strong growth in average earning assets, which increased 8.91% from September 30, 2008 to September 30, 2009.

Although the effective interest rate impact on earning assets and funding sources can be reasonably estimated at current interest rate levels, the options selected by customers, and the future mix of the loan, investment, and deposit products in the Bank's portfolios, may significantly change the estimates used in the simulation models. In addition, our net interest income may be impacted by further interest rate actions of the Federal Reserve Bank.



**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis***Provision for Loan Losses*

The provision for loan and lease losses is the expense necessary to maintain the allowance for loan and lease losses at a level adequate to absorb management's estimate of probable losses in the loan and lease portfolio. Mid Penn's provision for loan and lease losses is based upon management's monthly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans and leases, analyze delinquencies, ascertain loan and lease growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets we serve.

During the first nine months of 2009, Mid Penn continued to experience a challenging economic and operating environment. Given the economic pressures that impact some borrowers, the Corporation has increased the allowance for loan and lease losses in accordance with Mid Penn's assessment process, which took into consideration the decrease in collateral values from December 31, 2008 to September 30, 2009. The provision for loan and lease losses was \$1,108,000 for the three months ended September 30, 2009, as compared to \$275,000 for the three months ended September 30, 2008. During the nine months ended September 30, 2009, the provision for loan and lease losses was \$2,520,000, as compared to \$530,000 for the nine months ended September 30, 2008. For further discussion of factors affecting the provision for loan and lease losses please see *Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses* in the Financial Condition section of this Management's Discussion and Analysis.

*Noninterest Income*

Noninterest income decreased \$89,000, or 8.9% during the third quarter of 2009 versus the third quarter of 2008. During the nine months ended September 30, 2009, noninterest income decreased \$89,000, or 3.2% versus the same period in 2008. The following components of noninterest income showed significant changes:

	<b>Three Months Ended September 30,</b>			
	<b>\$</b>			
<b>(Dollars in Thousands)</b>	<b>2009</b>	<b>2008</b>	<b>Variance</b>	<b>% Variance</b>
Service charges on deposits	\$ 382	\$ 455	\$ (73)	(16.0)%
Mortgage banking income	\$ 37	\$ 11	\$ 26	236.4%

  

	<b>Nine Months Ended September 30,</b>			
	<b>\$</b>			
<b>(Dollars in Thousands)</b>	<b>2009</b>	<b>2008</b>	<b>\$ Variance</b>	<b>% Variance</b>
Service charges on deposits	\$ 1,119	\$ 1,303	\$ (184)	(14.1)%
Gain on life insurance proceeds	\$ 158	\$	\$ 158	N/A
Mortgage banking income	\$ 72	\$ 49	\$ 23	46.9%

Service charges on deposits, primarily fees from non-sufficient funds, showed decreases during both periods. During this period of economic downturn, customers seem to have become more conscientious about their account balances and avoiding unnecessary charges related to non-sufficient funds. The gain on life insurance proceeds was the result of recognition of insurance proceeds due to the death of a former Director in the first quarter of 2009. Mortgage banking income showed a solid increase in the quarter ended September 30, 2009 versus the same period in 2008 due to increased mortgage lending activity. A favorable interest rate environment, more focused sales efforts, and fewer competitors in the market have improved our results in this area.

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis***Noninterest Expenses*

Noninterest expenses increased by \$705,000, or 20.0% during the third quarter of 2009, versus the same period in 2008. During the nine months ended September 30, 2009, noninterest expenses increased \$1,991,000, or 19.1% over the same period in 2008. The increases were primarily a result of the following components of noninterest expense:

(Dollars in Thousands)	Three Months Ended September 30,			
	2009	2008	\$ Variance	% Variance
Salaries and employee benefits	\$ 2,102	\$ 1,832	\$ 270	14.7%
Equipment expense	\$ 304	\$ 208	\$ 96	46.2%
FDIC Assessment	\$ 347	\$ 12	\$ 335	2791.7%

(Dollars in Thousands)	Nine Months Ended September 30,			
	2009	2008	\$ Variance	% Variance
Salaries and employee benefits	\$ 6,224	\$ 5,428	\$ 796	14.7%
Equipment expense	\$ 848	\$ 634	\$ 214	33.8%
FDIC Assessment	\$ 871	\$ 45	\$ 826	1835.6%
Marketing and advertising expense	\$ 606	\$ 337	\$ 269	79.8%

The increases in salaries and employee benefits reflect the full quarter and year-to-date 2009 impact of added team members throughout 2008 to position Mid Penn for handling current needs and future growth. Increased equipment expenses in the third quarter reflect depreciation and equipment acquisition charges from the opening of the new operations center in Halifax. This facility fulfills much needed space enhancements for current and future growth. The increase in FDIC Assessment is the result of the agency's efforts to replenish the insurance fund in light of the wave of bank closures brought on by the sub-prime lending and credit crisis. The agency also levied a special assessment on all insured institutions as of June 30, 2009. This special assessment was calculated at five basis points of total assets less Tier 1 capital, and resulted in a charge to earnings of \$265,000 for Mid Penn during the second quarter of 2009. Marketing and advertising expenses are higher in 2009 as we take advantage of the market disruption caused by the sub-prime lending and credit crisis related mergers to increase core deposits. Two specific campaigns have been launched to achieve this goal. The first, late in the first quarter, was aimed at retaining or replacing with core deposits a large group of time deposits maturing during that period. The second was the sponsorship of the local Fourth of July Fireworks celebration as part of a drive to capture new core deposit accounts. These initiatives resulted in a concentration of marketing expenses in the first two quarters of 2009, while during the quarter ended September 30, 2009, marketing expenses were less than those during the same period in 2008.

*Income Taxes*

The benefit from income taxes was (\$93,000) for the three months ended September 30, 2009, as compared to a provision for income taxes of \$368,000 in the same period last year. The benefit from income taxes was (\$151,000) for the nine months ended September 30, 2009, as compared to a provision for income taxes of \$1,106,000 for the same period of last year. The tax benefit was related to the reduced net income stemming from the increased provision for loan losses and increased noninterest expenses during the first nine months of 2009 versus the same period in 2008. The effective tax rate, for the nine months ended September 30, 2009, was (13.6) % compared to 24.8% for the nine months ended September 30, 2008. Generally, our effective tax rate is below the statutory rate due to earnings on tax-exempt loans, investments, and bank-owned life insurance, and the impact of tax credits. The realization of deferred tax assets is dependent on future earnings. As a result of Mid Penn's adoption of ASC Topic 740, *Income Taxes*, no significant income tax uncertainties were identified, therefore, Mid Penn recognized no adjustment for unrealized income tax benefits for the periods ended September 30, 2009 and September 30, 2008. We currently anticipate that future earnings will be adequate to fully utilize deferred tax assets.

*Financial Condition**Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses*

During the first nine months of 2009, Mid Penn had net charge-offs of \$359,000 as compared to net charge-offs of \$253,000 during the same period of 2008. Mid Penn may need to make future adjustments to the allowance and the provision for loan and lease losses, if economic

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

conditions or loan credit quality differs substantially from the assumptions used in making the Corporation's evaluation of the level of the allowance for loan losses as compared to the balance of outstanding loans.

**Table of Contents**

MID PENN BANCORP, INC.

Management's Discussion and Analysis

*Analysis of the Allowance for Loan and Lease Losses:*

(Dollars in thousands)	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Average total loans outstanding (net of unearned income)	\$ 457,057	\$ 395,681
Period ending total loans outstanding (net of unearned income)	\$ 484,709	\$ 424,450
Balance, beginning of period	\$ 5,505	\$ 4,790
Loans charged off during period	(437)	(352)
Recoveries of loans previously charged off	78	99
Net chargeoffs	(359)	(253)
Provision for loan and lease losses	2,520	530
Balance, end of period	\$ 7,666	\$ 5,067
Ratio of net loans charged off to average loans outstanding (annualized)	0.11%	0.09%
Ratio of allowance for loan losses to net loans at end of period	1.58%	1.19%

During October of 2009, an additional \$992,000 in recommended partial and full loan charge offs on 20 credits will be presented to the Board of Directors for approval. The full charge offs represent loans on which any collectability is not expected and where collateral is not present or of insufficient value to offset the outstanding loan balance. The partial charge off recommendations represent loans on which collateral value is insufficient to cover all of the outstanding loan balance, however management's collection efforts have resulted in continuing payments on the loans. In the event that the borrower's financial condition improves, resulting in full repayment of the outstanding debt, MPB will record a recovery of the charged off portion.

At September 30, 2009, the allowance for loan and lease losses contained specific reserves totaling \$966,000 against this pool of loans being recommended for charge off. Any remaining balances on the loans partially charged off will remain rated as classified loans.

Other than as described herein, we do not believe there are any trends, events or uncertainties that are reasonably expected to have a material impact on future results of operations, liquidity, or capital resources. Further, based on known information, we believe that the effects of current and past economic conditions and other unfavorable business conditions may influence certain borrowers' abilities to comply with their repayment terms. The Corporation continues to monitor closely these borrowers' financial strength.

At September 30, 2009, total nonperforming loans amounted to \$9,699,000, or 2.00% of loans and leases net of unearned income, as compared to levels of \$4,164,000, or 0.96%, at December 31, 2008 and \$4,029,000, or 0.95%, at September 30, 2008.

*Schedule of Nonperforming Assets:*

(Dollars in thousands)	September 30, 2009	December 31, 2008	September 30, 2008
Nonperforming Assets:			
Nonaccrual loans	\$ 9,584	\$ 4,113	\$ 3,978
Loans renegotiated with borrowers	115	51	51

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Total nonperforming loans	9,699	4,164	4,029
Foreclosed real estate	388	1,516	1,374
Other repossessed property			
Total non-performing assets	10,087	5,680	5,403
Accruing loans 90 days or more past due	740	1,860	3,971
Total risk elements	\$ 10,827	\$ 7,540	\$ 9,374
Nonperforming loans as a % of total loans outstanding	2.00%	0.96%	0.95%
Nonperforming assets as a % of total loans outstanding and other real estate	2.08%	1.30%	1.27%
Ratio of allowance for loan losses to nonperforming loans	79.04%	132.20%	125.76%

---

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis**

Mid Penn considers a loan or lease to be impaired when, based upon current information and events, it is probable that all interest and principal payments due according to the contractual terms of the loan or lease agreement will not be collected. An insignificant delay or shortfall in the amounts of payments would not cause a loan or lease to be considered impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan or lease and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Larger groups of small-balance loans, such as residential mortgages and consumer installment loans are collectively evaluated for impairment. Accordingly, individual consumer and residential loans are not separately identified for impairment disclosures unless such loans are the subject of a restructuring agreement. As previously discussed in Note 9 of these interim consolidated financial statements, Mid Penn determines the fair value of impaired loans on a case-by-case basis based primarily upon the fair value of the underlying collateral using Level 3 inputs comprised of customized collateral value discounting analyses.

As of September 30, 2009, the Corporation had several unrelated loan relationships, with an aggregate carrying balance of \$8,213,000, deemed impaired that have been placed in nonaccrual status. Specific allocations totaling \$2,743,000 have been included within the loan loss reserve for these loans. Management currently believes that the specific reserve is adequate to cover potential future losses related to these relationships. There are several other significant unrelated loan relationships considered impaired, with outstanding balances of \$13,893,000, on which, interest continues to accrue. Specific allocations within the allowance for loan losses for these loans total \$1,082,000.

Mid Penn maintains the allowance for loan losses at a level believed adequate to absorb estimated probable loan losses. Management is responsible for the adequacy of the allowance for loan losses, which is formally reviewed on a monthly basis. The allowance is increased by a provision for loan and lease losses, which is charged to expense, and reduced by charge-offs, net of recoveries. The evaluation of the adequacy of the allowance is based on past loan loss experience, known and inherent risks in the portfolio, specific problem credits within the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. While current available information is used to make such evaluations, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation.

Various regulatory agencies, as an integral part of their examination process, review the Bank's allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgment of information available to them at the time of their examination. No adjustment to the allowance for loan losses was necessary as a result of our most recent regulatory examination.

Management currently believes, based on information currently available, that the current allowance for loan and lease losses of \$7,666,000 is adequate to meet potential loan and lease losses.

*Liquidity*

Mid Penn Bank's objective is to maintain adequate liquidity to meet funding needs at a reasonable cost and to provide contingency plans to meet unanticipated funding needs or a loss of funding sources, while minimizing interest rate risk. Adequate liquidity provides resources for credit needs of borrowers, for depositor withdrawals and for funding corporate operations. Sources of liquidity are as follows:

A growing core deposit base;

Proceeds from the sale or maturity of investment securities;

Proceeds from certificates of deposit in other financial institutions;

Payments received on loans and mortgage-backed securities; and,

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Overnight correspondent bank borrowings on various credit lines, and borrowing capacity available from the FHLB.

We believe that our core deposits are stable even in periods of changing interest rates like those that we are currently experiencing. Liquidity and funds management are governed by policies and are measured on a monthly basis. These measurements indicate that liquidity generally remains stable and exceeds our minimum defined levels of adequacy. Other than the trends of continued competitive pressures and volatile interest rates, there are no known demands, commitments, events, or uncertainties that will result in, or that are reasonably likely to result in, liquidity increasing or decreasing in any material way.

### *Capital Resources*

Mid Penn Bancorp, Inc. is a financial holding company and, as such, chooses to maintain a well-capitalized status in its bank subsidiary. Quantitative measures established by regulation to ensure capital adequacy require Mid Penn to maintain minimum amounts and ratios (set forth below) of Tier 1 capital to average assets and of total capital (as defined in the regulations) to risk-weighted assets. As of September 30, 2009 and December 31, 2008, Mid Penn met all capital adequacy requirements to which the Bank is subject, and the Bank is considered well-capitalized. However, future changes in regulations could increase capital requirements and may have an adverse effect on capital resources.

The FDIC Board has adopted a restoration plan that raised assessment rates for deposit insurance premiums for 2009, and enacted a special emergency assessment that has significantly affected operating results for the Corporation. The assessment was .05% of total Bank Assets, less Tier 1

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis**

Capital as of June 30, 2009, and was paid on September 30, 2009. The special assessment for Mid Penn's banking subsidiary was \$265,000.

The FDIC has also proposed a prepayment of projected deposit insurance premiums for a three-year period that would be paid on December 30, 2009. The prepayment is estimated to be approximately \$2,170,000 for the Corporation. The prepayment would be carried as a prepaid expense and amortized into expense in the operating period to which it applies.

Mid Penn maintained the following regulatory capital levels, leverage ratios, and risk-based capital ratios in its bank subsidiary as of September 30, 2009, and December 31, 2008, as follows:

(Dollars in thousands)	Capital Adequacy				To Be Well-Capitalized Under Prompt Corrective Action Provisions:	
	Actual:		Minimum Capital Required:		Amount	Ratio
	Amount	Ratio	Amount	Ratio		
As of September 30, 2009:						
Tier 1 Capital (to Average Assets)	\$ 48,038	8.2%	\$ 23,316	4.0%	\$ 29,145	5.0%
Tier 1 Capital (to Risk Weighted Assets)	48,038	10.0%	19,273	4.0%	28,910	6.0%
Total Capital (to Risk Weighted Assets)	54,082	11.2%	38,546	8.0%	48,183	10.0%
As of December 31, 2008:						
Tier 1 Capital (to Average Assets)	\$ 39,975	7.2%	\$ 22,146	4.0%	\$ 27,683	5.0%
Tier 1 Capital (to Risk Weighted Assets)	39,975	9.3%	17,278	4.0%	25,917	6.0%
Total Capital (to Risk Weighted Assets)	45,376	10.5%	34,556	8.0%	43,195	10.0%

*Capital Purchase Program Participation*

On December 19, 2008, Mid Penn Bancorp, Inc. (the Corporation) entered into and closed a Letter Agreement (including the Securities Purchase Agreement Standard Terms) (the Purchase Agreement) with the United States Department of the Treasury (the Treasury) pursuant to which the Treasury invested \$10,000,000 in the Company under the Treasury's Capital Purchase Program (the CPP).

Under the Purchase Agreement, the Treasury received (1) 10,000 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock, \$1,000 liquidation preference, and (2) Warrants to purchase up to 73,099 shares of the Corporation's common stock at an exercise price of \$20.52 per share.

The preferred shares pay cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. The preferred shares are non-voting, other than class voting rights on certain matters that could adversely affect the preferred shares. If dividends on the preferred shares have not been paid for an aggregate of six quarterly dividend periods or more, whether consecutive or not, the Corporation's authorized number of directors will automatically be increased by two, and holders of the preferred stock, voting together with holders of any then outstanding parity stock, will have the right to elect those directors at the Corporation's next annual meeting of shareholders or special meeting of shareholders called for that purpose. These preferred share directors would be elected annually and serve until all accrued and unpaid dividends on the preferred shares have been paid.

Pursuant to the American Recovery and Reinvestment Act of 2009, the Secretary of the Treasury shall permit, subject to consultation with the appropriate Federal banking agency, the Corporation to redeem the Series A Preferred Stock. The Corporation may do so without regard to the source of the funds to be used to redeem the Series A Preferred Stock or any minimum waiting period. If the Corporation elects to redeem the Series A Preferred Stock prior to February 15, 2012, and receives approval from the Treasury and the Board of Governors of the Federal Reserve System, it must redeem at least \$2,500,000 of the Series A Preferred Stock. Upon redemption of the Series A Preferred Stock, the Secretary of the Treasury shall liquidate the warrants associated with the Corporation's participation in the CPP at the current market price. Any redemption is subject to the consent of the Board of Governors of the Federal Reserve System. Until December 19, 2011, or such earlier time as all preferred shares have been redeemed by the Corporation or transferred by Treasury to third parties that are not affiliated with Treasury, the Corporation may not, without Treasury's consent, increase its dividend rate per share of common stock or, with certain limited exceptions, repurchase its common stock.



## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

The warrants are immediately exercisable and have a 10-year term. The exercise price and number of shares subject to the warrants are both subject to anti-dilution adjustments. Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the warrants; however, this agreement not to vote the shares does not apply to any person who may acquire such shares. If the Corporation receives aggregate gross proceeds of at least \$10,000,000 from one or more qualifying equity offerings of Tier 1-eligible perpetual preferred or common stock on or prior to December 31, 2009, the number of shares of common stock underlying the warrant then held by Treasury will be reduced by one half of the original number of shares underlying the warrants, after taking into account all adjustments.

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis**

The preferred shares and the warrants were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. The Corporation has filed a shelf registration statement covering the preferred shares, the warrants, and the common stock underlying the warrants. Treasury and other future holders of the preferred shares, the warrants, or the common stock issued pursuant to the warrants also have piggyback and demand registration rights with respect to these securities. None of the preferred shares, the warrants, or the shares issuable upon exercise of the warrants are subject to any contractual restrictions on transfer, except that Treasury may only transfer or exercise an aggregate of one-half of the warrants shares prior to December 31, 2009.

In the Purchase Agreement, the Corporation agreed that, until such time as the Treasury ceases to own any securities acquired from Mid Penn pursuant to the Purchase Agreement, the Corporation will take all necessary action to ensure that benefit plans with respect to our senior executive officers comply with Section 111(b) of the Emergency Economic Stability Act of 2008 (the "EESA") and applicable guidance or regulations issued by the Secretary of the Treasury. The applicable executive compensation requirements apply to the compensation of the Corporation's Chief Executive Officer, Chief Financial Officer, and other most highly compensated executive officers.

*Emergency Economic Stabilization Act of 2008*

On December 19, 2008, the United States Department of the Treasury purchased \$10 million of Fixed Rate Cumulative Perpetual Preferred Stock, Series A from Mid Penn under the Troubled Asset Relief Program ("TARP") Capital Purchase Program. Institutions that receive financial assistance under the TARP Capital Purchase Program must comply with the executive compensation and corporate governance requirements under Section 111 of the Emergency Economic Stabilization Act of 2008, which was amended by the American Recovery and Reinvestment Act of 2009. These requirements, the compliance of which must be annually certified by Mid Penn's Chief Executive Officer, Chief Financial Officer, and compensation committee include:

1. Limits on compensation that exclude incentives for senior executive officers of Mid Penn to take unnecessary and excessive risks that threaten the value of the Corporation during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding;
2. A provision for the recovery by Mid Penn of any bonus, retention award, or incentive compensation paid to a senior executive officer and any of the next 20 most highly-compensated employees of the Corporation based on statements of earnings, revenues, gains, or other criteria that are later found to be materially inaccurate;
3. A prohibition on the Corporation making any golden parachute payment to a senior executive officer or any of the next five most highly-compensated employees of Mid Penn during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding;
4. A prohibition on Mid Penn paying or accruing any bonus, retention award, or incentive compensation to the most highly compensated employee of the Corporation during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding, except that any prohibition shall not apply to the payment of long-term restricted stock by Mid Penn, provided that such long-term restricted stock
  - i. Does not fully vest during the period in which any obligation arising from financial assistance provided to the Corporation remains outstanding;
  - ii. Has a value in an amount that is not greater than one-third of the total amount of annual compensation of the employee receiving the stock; and

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

iii. Is subject to such other terms and conditions as the Secretary of the Treasury may determine is in the public interest;

5. Prohibition on any compensation plan that would encourage manipulation of the reported earnings of Mid Penn to enhance the compensation of any of its employees; and

6. Requirement that Mid Penn's compensation committee remains entirely independent and meets at least semiannually to discuss and evaluate employee compensation plans in light of an assessment of any risk posed to the Corporation from such plans.

In compliance with the EESA and ARRA, on February 27, 2009, Rory G. Ritrievi entered into a Capital Purchase Plan Executive Compensation Restriction Agreement with Mid Penn Bancorp, Inc. and Mid Penn Bank (the Agreement). The Agreement prohibits, during the period which any obligation to the Federal Government remains outstanding, any payment to Mr. Ritrievi (including bonus payments and payments upon a termination) which would violate the EESA and ARRA, despite Mr. Ritrievi having an employment agreement requiring payments upon certain terminations. Because Mr. Ritrievi was not employed by Mid Penn Bancorp, Inc. and Mid Penn Bank on December 31, 2008, the restrictions under the EESA and ARRA do not apply to Mr. Ritrievi until January 1, 2010.

In addition to these requirements, Mid Penn must have in place a company-wide policy regarding excessive or luxury expenditures and must permit a separate shareholder vote to approve the compensation of executives as disclosed pursuant to the compensation disclosure rules of the Securities and Exchange Commission.

### *Excessive or Luxury Expenditures*

On February 17, 2009, the President of the United States signed into law The American Recovery and Reinvestment Act of 2009 (ARRA). The ARRA requires each recipient of funds under the Capital Purchase Program (CPP) of the Troubled Assets Relief Program (TARP) to have in place a company-wide policy regarding excessive or luxury expenditures as identified by the Secretary of the Department of the Treasury. This policy

**Table of Contents**

**MID PENN BANCORP, INC.**

**Management's Discussion and Analysis**

is intended to fulfill these requirements under the ARRA.

It is the policy of Mid Penn Bancorp, Inc. and its subsidiary Mid Penn Bank (collectively the Bank ) to use corporate assets in a prudent manner and as such, their employees and directors are prohibited from engaging in excessive or luxury expenditures. This prohibition includes excessive or luxury expenditures on:

entertainment or events,

office and facility renovation,

aviation or other transportation services, and

other similar items, activities or events, which are not reasonable expenditures for staff development, reasonable performance incentives, or other similar reasonable measures conducted in the normal course of business operations.

---

**Table of Contents**

**MID PENN BANCORP, INC.**

**ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As a financial institution, Mid Penn's primary source of market risk is interest rate risk. Interest rate risk is the exposure to fluctuations in Mid Penn's future earnings (earnings at risk) resulting from changes in interest rates. This exposure or sensitivity is a function of the repricing characteristics of Mid Penn's portfolio of assets and liabilities. Each asset and liability reprices either at maturity or during the life of the instrument. Interest rate sensitivity is measured as the difference between the volume of assets and liabilities that are subject to repricing in a future period.

The principal purpose of asset-liability management is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Net interest income is increased by increasing the net interest margin and by volume growth. Thus, the goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

Mid Penn utilizes an asset-liability management model to measure the impact of interest rate movements on its interest rate sensitivity position. Mid Penn's management also reviews the traditional maturity gap analysis regularly. Mid Penn does not attempt to achieve an exact match between interest sensitive assets and liabilities because it believes that an actively managed amount of interest rate risk is inherent and appropriate in the management of the Corporation's profitability.

No material changes in the market risk strategy occurred during the current period and no material changes have been noted in the Corporation's equity value at risk. A detailed discussion of market risk is provided in the Form 10-K for the year ended December 31, 2008. Mid Penn enjoys a closely balanced position that does not place it at undue risk under any interest rate scenario. Deposit dollars in transaction accounts are discretionarily priced so management maintains significant pricing flexibility.

**ITEM 4 CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures*

Mid Penn maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the Corporation files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures as of September 30, 2009, the Corporation's Principal Executive Officer and Principal Financial and Accounting Officer concluded that the disclosure controls and procedures were adequate.

*Changes in Internal Controls*

During the nine months ended September 30, 2009, there were no changes in Mid Penn's internal controls over financial reporting, that have materially affected, or are reasonable likely to materially affect, these controls.

**PART II OTHER INFORMATION**

**ITEM 1 LEGAL PROCEEDINGS**

Management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of Mid Penn. There are no proceedings pending other than the ordinary routine litigation incident to the business of Mid Penn. In addition, management does not know of any material proceedings contemplated by governmental authorities against the Corporation or any of its properties.

**ITEM 1A RISK FACTORS**

There have been no material changes to the risk factors described in our Annual Report on Form 10-K for the year ended December 31, 2008.

**ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3 DEFAULTS UPON SENIOR SECURITIES**

None

**Table of Contents**

**MID PENN BANCORP, INC.**

**ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

**ITEM 5 OTHER INFORMATION**

None

**ITEM 6 EXHIBITS**

Exhibit 3(i) The Registrant's Amended and Restated Articles of Incorporation (Incorporated by reference to Exhibit 3(i) to Registrant's Quarterly Report on form 10-Q filed with the Securities and Exchange Commission on May 11, 2009.)

Exhibit 3(ii) Statement with Respect to Shares for Series A Preferred Stock. (Incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 22, 2008.)

Exhibit 3(iii) The Registrant's Amended and Restated By-laws (Incorporated by reference to Exhibit 3(iii) to Registrant's Quarterly Report on form 10-Q filed with the Securities and Exchange Commission on May 11, 2009.)

Exhibit 4 Warrants for Purchase of Shares of Common Stock. (Incorporated by reference to Exhibit 4.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 22, 2008.)

Exhibit 10.1 Mid Penn Bank's Profit Sharing Retirement Plan. (Incorporated by reference to Exhibit 10.1 to Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 10, 2008.)

Exhibit 10.2 Mid Penn Bank's Employee Stock Ownership Plan. (Incorporated by reference to Exhibit 10.2 to Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 10, 2008.)

Exhibit 10.3 The Registrant's Dividend Reinvestment Plan, as amended and restated. (Incorporated by reference to Exhibit 99.1 to Registrant's Registration Statement on Form S-3, filed with the Securities and Exchange Commission on October 12, 2005.)

Exhibit 10.4 Split Dollar Agreement between Mid Penn Bank and Eugene F. Shaffer. (Incorporated by reference to Exhibit 10.5 to Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 14, 2005.)

Exhibit 10.5 Death Benefit Plan and Agreement between Mid Penn Bank and the Trustee of the Eugene F. Shaffer Irrevocable Trust. (Incorporated by reference to Exhibit 10.6 to Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 14, 2005.)

Exhibit 10.6 Severance Agreement dated as of November 26, 2008 between Mid Penn Bank and Alan W. Dakey. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on

## Edgar Filing: MID PENN BANCORP INC - Form 10-Q

December 1, 2008.)

Exhibit 10.7 Letter Agreement, dated as of December 19, 2008, Between Mid Penn Bancorp, Inc. and the United States Department of the Treasury, which includes the Securities Purchase Agreement Standard Terms attached thereto, with respect to the issuance and sale of the Series A Preferred Stock and the Warrants. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on form 8-K as filed with the Securities and Exchange Commission on December 22, 2008.)

Exhibit 10.8 Key Executive Management Change of Control between Mid Penn Bancorp, Inc. and Kevin W. Laudenslager dated as of April 1, 2008. (Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on form 8-K filed with the Securities and Exchange Commission on April 4, 2008.)

Exhibit 10.9 Revised Directors' Retirement Plan (Incorporated by reference to Exhibit 10.9 to Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 8, 2008.)

Exhibit 10.10 Employment Agreement of Rory G. Ritrievi dated as of February 25, 2009 (Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on March 2, 2009.)

Exhibit 10.11 Form of Capital Purchase Plan Executive Compensation Restriction Agreement (Incorporated by reference to



**Table of Contents**

**MID PENN BANCORP, INC.**

Exhibit 99.3 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on March 2, 2009.)

Exhibit 11 Statement regarding the computation of Per Share Earnings. (Incorporated by reference to Part I Item 1 of this Quarterly Report on Form 10-Q.)

Exhibit 31.1 Certification of Principal Executive Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31.2 Certification of Principal Financial Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32 Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002.

**Table of Contents**

**MID PENN BANCORP, INC.**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Mid Penn Bancorp, Inc.**

(Registrant)

By: /s/ RORY G. RITRIEVI  
**Rory G. Ritrievi**

**President and CEO**

**(Principal Executive Officer)**

Date: November 9, 2009

By: /s/ KEVIN W. LAUDENSLAGER  
**Kevin W. Laudenslager**

**Treasurer**

**(Principal Financial and Accounting Officer)**

Date: November 9, 2009