Navios Maritime Partners L.P.
Form 20-F
March 07, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**
OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

OR

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

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report

For the transition period from to

Commission file number

333-146972

Navios Maritime Partners L.P.

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant s Name into English)

Republic of Marshall Islands

(Jurisdiction of incorporation or organization)

85 Akti Miaouli Street

Piraeus, Greece 185 38

(011) +30-210-4595000

(Address of principal executive offices)

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
Common Units	New York Stock Exchange LLC

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

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act. None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

46,887,320 Common Units

7,621,843 Subordinated Units

1,000,000 Subordinated Series A Units

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or (15)(d) of the Securities Exchange Act of 1934. Yes ¨ No x

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

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

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

Large Accelerated Filer ¨ Accelerated Filer x Non-Accelerated Filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP x International Financial Reporting Standards as issued by the International Accounting Standards Board ¨ Other ¨

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

TABLE OF CONTENTS

Table of Contents

FORWARD-LOOKING STATEMENTS

This Annual Report should be read in conjunction with the consolidated financial statements and accompanying notes included in this report.

Statements included in this annual report which are not historical facts (including our statements concerning plans and objectives of management for future operations or economic performance, or assumptions related thereto) are forward-looking statements. In addition, we and our representatives may from time to time make other oral or written statements which are also forward-looking statements. Such statements include, in particular, statements about our plans, strategies, business prospects, changes and trends in our business, and the markets in which we operate as described in this annual report. In some cases, you can identify the forward-looking statements by the use of words such as may, could, should, would, expect, plan, anticipate, intend, forecast, believe, estimate, predict, propose, potential, contin terms or other comparable terminology.

Forward-looking statements appear in a number of places and include statements with respect to, among other things:

- our ability to make cash distributions on our common units;
- our future financial condition or results of operations and our future revenues and expenses;
- our anticipated growth strategies;
- future charter hire rates and vessel values;
- the repayment of debt;
- our ability to access debt and equity markets;
- planned capital expenditures and availability of capital resources to fund capital expenditures;
- future supply of, and demand for, drybulk commodities;
- increases in interest rates;
- our ability to maintain long-term relationships with major commodity traders;
- our ability to leverage to our advantage Navios Maritime Holdings Inc. s relationships and reputation in the shipping industry;
- our continued ability to enter into long-term, fixed-rate time charters;

our ability to maximize the use of our vessels, including the re-deployment or disposition of vessels no longer under long-term time charter;

timely purchases and deliveries of newbuilding vessels;

future purchase prices of newbuildings and secondhand vessels;

our ability to compete successfully for future chartering and newbuilding opportunities;

the expected cost of, and our ability to comply with, governmental regulations and maritime self-regulatory organization standards, as well as standard regulations imposed by our charterers applicable to our business;

our anticipated incremental general and administrative expenses as a publicly traded limited partnership and our expenses under the management agreement and the administrative services agreement with Navios ShipManagement Inc., a subsidiary of Navios Maritime Holdings Inc. (the Manager) and for reimbursements for fees and costs of our general partner;

the anticipated taxation of our partnership and our unitholders;

Table of Contents

estimated future maintenance and replacement capital expenditures;

expected demand in the drybulk shipping sector in general and the demand for our Panamax, Capesize and Ultra-Handymax vessels in particular;

our ability to retain key executive officers;

customers   increasing emphasis on environmental and safety concerns;

future sales of our common units in the public market; and

our business strategy and other plans and objectives for future operations.

These and other forward-looking statements are made based upon management s current plans, expectations, estimates, assumptions and beliefs concerning future events impacting us and therefore involve a number of risks and uncertainties, including those set forth below, as well as those risks discussed in   Item 3. Key Information .

a lack of sufficient cash to pay the minimum quarterly distribution on our common units;

the cyclical nature of the international drybulk shipping industry;

fluctuations in charter rates for drybulk carriers;

the historically high numbers of newbuildings currently under construction in the drybulk industry;

changes in the market values of our vessels and the vessels for which we have purchase options;

an inability to expand relationships with existing customers and obtain new customers;

the loss of any customer or charter or vessel;

the aging of our fleet and resultant increases in operations costs;

damage to our vessels;

general domestic and international political conditions, including wars, terrorism and piracy; and other factors detailed from time to time in our periodic reports filed with the Securities and Exchange Commission.

The risks, uncertainties and assumptions involve known and unknown risks and are inherently subject to significant uncertainties and contingencies, many of which are beyond our control. We caution that forward-looking statements are not guarantees and that actual results could differ materially from those expressed or implied in the forward-looking statements.

We undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict all of these factors. Further, we cannot assess the impact of each such factor on our business or the extent to which any factor, or combination of factors, may cause actual results to be materially different from those contained in any forward-looking statement.

Table of Contents

PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not Applicable.

Item 2. Offer Statistics and Expected Timetable

Not Applicable.

Item 3. Key Information

A. Selected Financial Data

In connection with the initial public offering (IPO) of Navios Maritime Partners L.P. (sometimes referred to as Navios Partners , the Partnership , we or us) on November 16, 2007 Navios Partners acquired interests in five wholly-owned subsidiaries of Navios Maritime Holdings Inc. (Navios Holdings), each of which owned a Panamax drybulk carrier (the Initial Vessels), as well as interests in three wholly-owned subsidiaries of Navios Holdings that operated and had options to purchase three additional vessels.

The following tables present, in each case for the periods and as of the dates indicated:

- for the period prior to the IPO selected historical financial and operating data of the five vessel-owing subsidiaries of Navios Holdings (collectively with Navios Holdings, the Company) that owned the Initial Vessels prior to the IPO; and

- selected historical financial and operating data of Navios Partners and its subsidiaries since the IPO.

The selected historical financial and operating results for the years ended December 31, 2007, 2008, 2009, 2010 and 2011 are derived from the audited consolidated financial statements of Navios Partners.

The historical consolidated financial statements of the Company prior to the IPO on November 16, 2007 have been carved out of the consolidated financial statements of Navios Holdings and reflect the consolidated financial position, results of operations and cash flows of the Company. These consolidated financial statements have been presented using historical carrying costs of the five vessel-owning subsidiaries for all periods presented as each vessel-owning company was under common control of Navios Holdings. Results of operations have been included from the respective dates (i) that the vessel-owning subsidiaries were acquired or when rights to operate the vessels were obtained by Navios Holdings or Navios Partners, as the case may be, or (ii) at the inception of charter-in agreements for chartered-in vessels.

As a result, the following tables should be read together with, and are qualified in their entirety by reference to, (a) Item 5. Operating and Financial Review and Prospects, included herein, and (b) the historical consolidated financial statements and the accompanying notes and the Report of Independent Registered Public Accounting Firm therein, with respect to the consolidated financial statements for the years ended December 31, 2011, 2010 and 2009.

Table of Contents

	Year ended December 31, 2011	2010	2009	2008	2007
	(Expressed in thousands of U.S. dollars-except per unit data)				
Statement of Income Data					
Time charter revenues	$ 186,953	$ 143,231	$ 92,643	$ 75,082	$ 50,352
Time charter expenses	(13,473)	(12,027)	(13,925)	(11,598)	(8,352)
Direct vessel expenses	(61)	(92)	(415)	(578)	(5,608)
Management fees	(26,343)	(19,746)	(11,004)	(9,275)	(920)
General and administrative expenses	(4,965)	(4,303)	(3,208)	(3,798)	(1,419)
Depreciation and amortization	(63,971)	(41,174)	(15,877)	(11,865)	(9,375)
Write-off of intangible asset	(3,979)				
Interest expense and finance cost, net	(9,244)	(6,360)	(8,048)	(9,216)	(5,522)
Interest income	821	1,017	261	301	
Compensation expense			(6,082)		
Other income	272	85	94	23	93
Other expenses	(675)	(120)	(117)	(318)	(226)
Income before income taxes	$ 65,335	$ 60,511	$ 34,322	$ 28,758	$ 19,023
Deferred income tax					485
Net income	**$ 65,335**	**$ 60,511**	**$ 34,322**	**$ 28,758**	**$ 19,508**
Earnings per unit (basic and diluted):					
Common unit (basic and diluted)	$ 1.33	$ 1.51	$ 1.47	$ 1.56	$ 0.15
Subordinated unit (basic and diluted)	$ 0.46	$ 1.11	$ 1.09	$ 1.22	$ 2.30
General partner unit (basic and diluted)	$ 1.19	$ 1.42	$ 1.40	$ 1.53	$ 1.06
Balance Sheet Data (at period end)					
Current assets, including cash	$ 63,558	$ 55,612	$ 92,579	$ 29,058	$ 11,312
Vessels, net	667,213	612,358	299,695	291,340	135,976
Total assets	909,924	840,885	436,756	322,907	205,054
Current portion of long-term debt	36,700	29,200		40,000	
Total long-term debt, including current portion	326,050	321,500	195,000	235,000	165,000
Total Owner s Net Investment and Partners Capital	559,639	491,503	207,990	76,847	26,786
Cash Flow Data					
Net cash provided by operating activities	$ 127,464	$ 96,018	$ 80,565	$ 41,744	$ 10,516
Net cash used in investing activities	(120,000)	(447,757)	(69,100)	(69,505)	
Net cash (used in)/provided by financing activities	(10,664)	325,139	38,039	46,040	(421)
Fleet Data:					
Vessels at end of period[1]	18	16	11	9	7

(1) Includes owned and chartered-in vessels.

B. Capitalization and indebtedness.

Not applicable.

C. Reasons for the offer and use of proceeds.

Not applicable.

Table of Contents

D. Risk factors

Risks Inherent in Our Business

We may not have sufficient cash from operations to enable us to pay the minimum quarterly distribution on our common units following the establishment of cash reserves and payment of fees and expenses or to maintain or increase distributions.

We may not have sufficient cash available each quarter to pay the minimum quarterly distribution of $0.35 per common unit following the establishment of cash reserves and payment of fees and expenses. The amount of cash we can distribute on our common units depends principally upon the amount of cash we generate from our operations, which may fluctuate based on numerous factors including, among other things:

- the rates we obtain from our charters and the market for long-term charters when we recharter our vessels;
- the level of our operating costs, such as the cost of crews and insurance, following the expiration of the fixed term of our management agreement pursuant to which we pay a fixed daily fee until December 2013;
- the number of unscheduled off-hire days for our fleet and the timing of, and number of days required for, scheduled inspection, maintenance or repairs of submerged parts, or drydocking, of our vessels;
- demand for drybulk commodities;
- supply of drybulk vessels;
- prevailing global and regional economic and political conditions; and
- the effect of governmental regulations and maritime self-regulatory organization standards on the conduct of our business.

The actual amount of cash we will have available for distribution also will depend on other factors, some of which are beyond our control, such as:

- the level of capital expenditures we make, including those associated with maintaining vessels, building new vessels, acquiring existing vessels and complying with regulations;
- our debt service requirements and restrictions on distributions contained in our debt instruments;
- interest rate fluctuations;
- the cost of acquisitions, if any;

- fluctuations in our working capital needs;
- our ability to make working capital borrowings, including the payment of distributions to unitholders; and
- the amount of any cash reserves, including reserves for future maintenance and replacement capital expenditures, working capital and other matters, established by our board of directors in its discretion.

The amount of cash we generate from our operations may differ materially from our profit or loss for the period, which will be affected by non-cash items. As a result of this and the other factors mentioned above, we may make cash distributions during periods when we record losses and may not make cash distributions during periods when we record net income.

The cyclical nature of the international drybulk shipping industry may lead to decreases in long-term charter rates and lower vessel values, resulting in decreased distributions to our common unitholders.

Table of Contents

The shipping business, including the dry cargo market, is cyclical in varying degrees, experiencing severe fluctuations in charter rates, profitability and, consequently, vessel values. For example, during the period from January 1, 2010 to December 31, 2011, the Baltic Exchange s Panamax time charter average daily rates experienced a low of $10,372 and a high of $37,099. Additionally, during the period from January 1, 2010 to December 31, 2011, the Baltic Exchange s Capesize time charter average daily rates experienced a low of $4,567 and a high of $59,324 and the Baltic Dry Index experienced a low of 1,043 points and a high of 4,209 points. We anticipate that the future demand for our drybulk carriers and drybulk charter rates will be dependent upon demand for imported commodities, economic growth in the emerging markets, including the Asia Pacific region, India, Brazil and Russia and the rest of the world, seasonal and regional changes in demand and changes to the capacity of the world fleet. Recent adverse economic, political, social or other developments have decreased demand and prospects for growth in the shipping industry and thereby could reduce revenue significantly. A decline in demand for commodities transported in drybulk carriers or an increase in supply of drybulk vessels could cause a further decline in charter rates, which could materially adversely affect our results of operations and financial condition. If we sell a vessel at a time when the market value of our vessels has fallen, the sale may be at less than the vessel s carrying amount, resulting in a loss.

The demand for vessels has generally been influenced by, among other factors:

- global and regional economic conditions;
- developments in international trade;
- changes in seaborne and other transportation patterns, such as port congestion and canal closures;
- weather and crop yields;
- armed conflicts and terrorist activities including piracy;
- political developments; and
- embargoes and strikes.

The supply of vessel capacity has generally been influenced by, among other factors:

- the number of vessels that are in or out of service;
- the scrapping rate of older vessels;
- port and canal traffic and congestion;
- the number of newbuilding deliveries; and

vessel casualties.

Charter rates in the drybulk shipping industry have decreased from their historically high levels and may decrease further in the future, which may adversely affect our earnings and ability to pay dividends.

The industry s current charter rates have significantly decreased from their historic highs reached in the second quarter of 2008. If the drybulk shipping industry, which has been highly cyclical, is depressed in the future when our charters expire or at a time when we may want to sell a vessel, our earnings and available cash flow may be adversely affected. We cannot assure you that we will be able to successfully charter our vessels in the future or renew our existing charters at rates sufficient to allow us to operate our business profitably, to meet our obligations, including payment of debt service to our lenders, or to pay dividends to our unitholders. Our ability to renew the charters on our vessels on the expiration or termination of our current charters, or on vessels that we may acquire in the future, the charter rates payable under any replacement charters and vessel values will depend upon, among other things, economic conditions in the sectors in which our vessels operate at that time, changes in the supply and demand for vessel capacity and changes in the supply and demand for the transportation of commodities.

All of our time charters are scheduled to expire on dates ranging from July 2012 to September 2022. If, upon expiration or termination of these or other contracts, long-term recharter rates are lower than existing rates, particularly considering that we intend to enter into long-term charters, or if we are unable to obtain replacement charters, our earnings, cash flow and our ability to make cash distributions to our unitholders could be materially adversely affected.

The market values of our vessels, which have declined from historically high levels, may fluctuate significantly, which could cause us to breach covenants in our credit facilities and result in the foreclosure on our mortgaged vessels.

Table of Contents

Factors that influence vessel values include:

- number of newbuilding deliveries;
- number of vessels scrapped or otherwise removed from the total fleet;
- changes in environmental and other regulations that may limit the useful life of vessels;
- changes in global drybulk commodity supply;
- types and sizes of vessels;
- development of and increase in use of other modes of transportation;
- cost of vessel acquisitions;
- governmental or other regulations;
- prevailing level of charter rates; and
- general economic and market conditions affecting the shipping industry.

If the market values of our owned vessels decrease, we may breach covenants contained in our credit facilities. We purchased our vessels from Navios Holdings based on market prices that were at historically high levels. If we breach the credit facilities covenants and are unable to remedy any relevant breach, our lenders could accelerate our debt and foreclose on the collateral, including our vessels. Any loss of vessels would significantly decrease our ability to generate positive cash flow from operations and therefore service our debt. In addition, if the book value of a vessel is impaired due to unfavorable market conditions, or a vessel is sold at a price below its book value, we would incur a loss.

We must make substantial capital expenditures to maintain the operating capacity of our fleet, which will reduce our cash available for distribution. In addition, each quarter our board of directors is required to deduct estimated maintenance and replacement capital expenditures from operating surplus, which may result in less cash available to unitholders than if actual maintenance and replacement capital expenditures were deducted.

We must make substantial capital expenditures to maintain, over the long term, the operating capacity of our fleet. These maintenance and replacement capital expenditures include capital expenditures associated with drydocking a vessel, modifying an existing vessel or acquiring a new vessel to the extent these expenditures are incurred to maintain the operating capacity of our fleet.

These expenditures could increase as a result of changes in:

- the cost of our labor and materials;

- the cost of suitable replacement vessels;
- customer/market requirements;
- increases in the size of our fleet; and
- governmental regulations and maritime self-regulatory organization standards relating to safety, security or the environment.

Our significant maintenance and replacement capital expenditures will reduce the amount of cash we have available for distribution to our unitholders. Any costs associated with scheduled drydocking until December 31, 2013 are included in a daily fee that we pay the Manager under a management agreement. In October 2011, we fixed the rate with the Manager for the period from November 17, 2011 until December 31, 2013 at: (a) $4,650 daily rate per owned Ultra-Handymax vessel, (b) $4,550 daily rate per Panamax vessel and (c) $5,650 daily rate per Capesize vessel, while the term of the Manager is until December 31, 2017. From January 1, 2014 to December 31, 2017, we expect that we will reimburse Navios ShipManagement for all of the actual operating costs and expenses it incurs in connection with the management of our fleet, which may result in significantly higher fees for that period. In the event our management agreement is not renewed, we will separately deduct estimated capital expenditures associated with drydocking from our operating surplus in addition to estimated replacement capital expenditures.

Our partnership agreement requires our board of directors to deduct estimated, rather than actual, maintenance and replacement capital expenditures from operating surplus each quarter in an effort to reduce fluctuations in operating surplus. The amount of estimated capital expenditures deducted from operating surplus is subject to review and change by the conflicts committee of our

Table of Contents

board of directors at least once a year. If our board of directors underestimates the appropriate level of estimated maintenance and replacement capital expenditures, we may have less cash available for distribution in future periods when actual capital expenditures begin to exceed previous estimates.

If we expand the size of our fleet in the future, we generally will be required to make significant installment payments for acquisitions of vessels even prior to their delivery and generation of revenue. Depending on whether we finance our expenditures through cash from operations or by issuing debt or equity securities, our ability to make cash distributions to unitholders may be diminished or our financial leverage could increase or our unitholders could be diluted.

The actual cost of a vessel varies significantly depending on the market price, the size and specifications of the vessel, governmental regulations and maritime self-regulatory organization standards.

If we purchase additional vessels in the future, we generally will be required to make installment payments prior to their delivery. If we finance these acquisition costs by issuing debt or equity securities, we will increase the aggregate amount of interest payments or minimum quarterly distributions we must make prior to generating cash from the operation of the vessel. We filed a shelf registration statement on November 2, 2010, under which we may sell any combination of securities (debt or equity) for up to a total of $500.0 million.

To fund the remaining portion of these and other capital expenditures, we will be required to use cash from operations or incur borrowings or raise capital through the sale of debt or additional equity securities. Use of cash from operations will reduce cash available for distributions to unitholders. Our ability to obtain bank financing or to access the capital markets for future offerings may be limited by our financial condition at the time of any such financing or offering as well as by adverse market conditions resulting from, among other things, general economic conditions and contingencies and uncertainties that are beyond our control. Our failure to obtain the funds for necessary future capital expenditures could have a material adverse effect on our business, results of operations and financial condition and on our ability to make cash distributions. Even if we successfully obtain necessary funds, the terms of such financings could limit our ability to pay cash distributions to unitholders. In addition, incurring additional debt may significantly increase our interest expense and financial leverage, and issuing additional equity securities may result in significant unitholder dilution and would increase the aggregate amount of cash required to meet our minimum quarterly distribution to unitholders, which could have a material adverse effect on our ability to make cash distributions to unitholders.

Our debt levels may limit our flexibility in obtaining additional financing and in pursuing other business opportunities and our interest rates under our credit facilities may fluctuate and may impact our operations.

Our credit facilities, as amended, provide us with the ability to borrow up to $326.1 million, of which $326.1 million was outstanding as of December 31, 2011. As of December 31, 2011, there was no undrawn amount under our credit facilities. We have the ability to incur additional debt, subject to limitations in our credit facilities. Our level of debt could have important consequences to us, including the following:

- our ability to obtain additional financing, if necessary, for working capital, capital expenditures, acquisitions or other purposes may be impaired or such financing may not be available on favorable terms;

- we will need a substantial portion of our cash flow to make principal and interest payments on our debt, reducing the funds that would otherwise be available for operations, future business opportunities and distributions to unitholders;

- our debt level will make us more vulnerable than our competitors with less debt to competitive pressures or a downturn in our business or the economy generally; and

- our debt level may limit our flexibility in responding to changing business and economic conditions.

Our ability to service our debt depends upon, among other things, our future financial and operating performance, which will be affected by prevailing economic conditions and financial, business, regulatory and other factors, some of which are beyond our control. Our ability to service debt under our credit facilities also will depend on market interest rates, since the interest rates applicable to our borrowings will fluctuate with the London Interbank Offered Rate, or LIBOR, or the prime rate. We do not currently hedge against increases in such rates and, accordingly, significant increases in such rate would require increased debt levels and reduce distributable cash. If our operating results are not sufficient to service our current or future indebtedness, we will be forced to take actions such as reducing distributions, reducing or delaying our business activities, acquisitions, investments or capital expenditures, selling assets, restructuring or refinancing our debt, or seeking additional equity capital or bankruptcy protection. We may not be able to affect any of these remedies on satisfactory terms, or at all.

Our credit facilities contain restrictive covenants, which may limit our business and financing activities.

On November 15, 2007, Navios Partners entered into a credit facility agreement with Commerzbank AG and DVB Bank AG (the Credit Facility) maturing on November 15, 2017 and entered into several amendments since then, to fund its fleet expansion (see Item 5-Operating and Financial Review and Prospects).

On May 27, 2011, Navios Partners entered into a facility agreement with Commerzbank AG and DVB Bank SE (the May 2011 Credit Facility, and together with the Credit Facility, the Credit Facilities), and borrowed an amount of $35.0 million to partially finance the acquisitions of the Navios Luz and the Navios Orbiter.

The operating and financial restrictions and covenants in our Credit Facilities and any future credit facility could adversely affect our ability to finance future operations or capital needs or to engage, expand or pursue our business activities. For example, our credit facilities require the consent of our lenders or limit our ability to, among other items:

- incur or guarantee indebtedness;
- charge, pledge or encumber the vessels;
- merge or consolidate;
- change the flag, class or commercial and technical management of our vessels;
- make cash distributions;
- make new investments; and
- sell or change the ownership or control of our vessels.

Our Credit Facilities also require us to comply with the International Safety Management Code, or ISM Code, and International Ship and Port Facilities Security Code, or ISPS Code, and to maintain valid safety management certificates and documents of compliance at all times.

In addition, our Credit Facilities require us to:

- maintain a required security amount of over 143%;
- maintain minimum free consolidated liquidity (which may be in the form of undrawn commitments under the Credit Facilities) of at least $20.0 million as of December 31, 2011, at which level it is required to be maintained thereafter);
- maintain a ratio of EBITDA to interest expense of at least 2.00 : 1.00;

- maintain a ratio of total liabilities to total assets (as defined in our Credit Facilities) of less than 0.75 : 1.00; and

- maintain a minimum net worth to $150.0 million.

Our ability to comply with the covenants and restrictions that are contained in our Credit Facilities and any other debt instruments we may enter into in the future may be affected by events beyond our control, including prevailing economic, financial and industry conditions. If market or other economic conditions deteriorate, our ability to comply with these covenants may be impaired. If we are in breach of any of the restrictions, covenants, ratios or tests in our Credit Facilities, especially if we trigger a cross default currently contained in certain of our loan agreements, a significant portion of our obligations may become immediately due and payable, and our lenders commitment to make further loans to us may terminate. We may not have, or be able to obtain, sufficient funds to make these accelerated payments. In addition, our obligations under our Credit Facilities are secured by certain of our vessels, and if we are unable to repay borrowings under such Credit Facilities, lenders could seek to foreclose on those vessels.

Restrictions in our debt agreements may prevent us from paying distributions to unitholders.

Our payment of principal and interest on the debt will reduce cash available for distribution on our common units. In addition, our Credit Facilities prohibit the payment of distributions if we are not in compliance with certain financial covenants or upon the occurrence of an event of default.

Table of Contents

Events of default under our Credit Facilities include, among other things, the following:

- failure to pay any principal, interest, fees, expenses or other amounts when due;
- failure to observe any other agreement, security instrument, obligation or covenant beyond specified cure periods in certain cases;
- default under other indebtedness;
- an event of insolvency or bankruptcy;
- material adverse change in the financial position or prospects of us or our general partner;
- failure of any representation or warranty to be materially correct; and
- failure of Navios Holdings or its affiliates (as defined in the Credit Facilities agreements) to own at least 20% of us.

We anticipate that any subsequent refinancing of our current debt or any new debt will have similar restrictions.

We depend on Navios Holdings and its affiliates to assist us in operating and expanding our business.

Pursuant to a management agreement between us and the Manager, the Manager provides to us significant commercial and technical management services (including the commercial and technical management of our vessels, vessel maintenance and crewing, purchasing and insurance and shipyard supervision). In addition, pursuant to an administrative services agreement between us and the Manager, the Manager provides to us significant administrative, financial and other support services. Our operational success and ability to execute our growth strategy depends significantly upon the Manager s satisfactory performance of these services. Our business will be harmed if the Manager fails to perform these services satisfactorily, if the Manager cancels either of these agreements, or if the Manager stops providing these services to us. We may also in the future contract with Navios Holdings for it to have newbuildings constructed on our behalf and to incur the construction-related financing. We would purchase the vessels on or after delivery based on an agreed-upon price.

Our ability to enter into new charters and expand our customer relationships will depend largely on our ability to leverage our relationship with Navios Holdings and its reputation and relationships in the shipping industry. If Navios Holdings suffers material damage to its reputation or relationships, it may harm our ability to:

- renew existing charters upon their expiration;
- obtain new charters;
- successfully interact with shipyards during periods of shipyard construction constraints;
- obtain financing on commercially acceptable terms; or

- maintain satisfactory relationships with suppliers and other third parties.

If our ability to do any of the things described above is impaired, it could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

As we expand our business, we may have difficulty managing our growth, which could increase expenses.

We intend to seek to grow our fleet, either through purchases, the increase of the number of chartered-in vessels or through the acquisitions of businesses. The addition of vessels to our fleet or the acquisition of new businesses will impose significant additional responsibilities on our management and staff. We will also have to increase our customer base to provide continued employment for the new vessels. Our growth will depend on:

- locating and acquiring suitable vessels;
- identifying and consummating acquisitions or joint ventures;
- integrating any acquired business successfully with our existing operations;
- enhancing our customer base;
- managing our expansion; and
- obtaining required financing.

Table of Contents

Growing any business by acquisition presents numerous risks such as undisclosed liabilities and obligations, difficulty in obtaining additional qualified personnel, and managing relationships with customers and suppliers and integrating newly acquired operations into existing infrastructures. We cannot give any assurance that we will be successful in executing our growth plans or that we will not incur significant expenses and losses in connection therewith or that our acquisitions will perform as expected, which could materially adversely affect our results of operations and financial condition.

Our growth depends on continued growth in demand for drybulk commodities and the shipping of drybulk cargoes.

Our growth strategy focuses on expansion in the drybulk shipping sector. Accordingly, our growth depends on continued growth in world and regional demand for drybulk commodities and the shipping of drybulk cargoes, which could be negatively affected by a number of factors, such as declines in prices for drybulk commodities, or general political and economic conditions.

Reduced demand for drybulk commodities and the shipping of drybulk cargoes would have a material adverse effect on our future growth and could harm our business, results of operations and financial condition. In particular, Asian Pacific economies and India have been the main driving force behind the current increase in seaborne drybulk trade and the demand for drybulk carriers. A negative change in economic conditions in any Asian Pacific country, but particularly in China, Japan or India, may have a material adverse effect on our business, financial condition and results of operations, as well as our future prospects, by reducing demand and resultant charter rates.

Our growth depends on our ability to expand relationships with existing customers and obtain new customers, for which we will face substantial competition.

Long-term time charters have the potential to provide income at pre-determined rates over more extended periods of time. However, the process for obtaining longer term time charters is highly competitive and generally involves a lengthy, intensive and continuous screening and vetting process and the submission of competitive bids that often extends for several months. In addition to the quality, age and suitability of the vessel, longer term shipping contracts tend to be awarded based upon a variety of other factors relating to the vessel operator, including:

- the operator s environmental, health and safety record;
- compliance with International Maritime Organization, or IMO, standards and the heightened industry standards that have been set by some energy companies;
- shipping industry relationships, reputation for customer service, technical and operating expertise;
- shipping experience and quality of ship operations, including cost-effectiveness;
- quality, experience and technical capability of crews;
- the ability to finance vessels at competitive rates and overall financial stability;
- relationships with shipyards and the ability to obtain suitable berths;
- construction management experience, including the ability to procure on-time delivery of new vessels according to customer specifications;

- willingness to accept operational risks pursuant to the charter, such as allowing termination of the charter for force majeure events; and

- competitiveness of the bid in terms of overall price.

It is likely that we will face substantial competition for long-term charter business from a number of experienced companies. Many of these competitors have significantly greater financial resources than we do. It is also likely that we will face increased numbers of competitors entering into our transportation sectors, including in the drybulk sector. Many of these competitors have strong reputations and extensive resources and experience. Increased competition may cause greater price competition, especially for long-term charters.

As a result of these factors, we may be unable to expand our relationships with existing customers or obtain new customers for long-term charters on a profitable basis, if at all. However, even if we are successful in employing our vessels under longer term charters, our vessels will not be available for trading in the spot market during an upturn in the drybulk market cycle, when spot trading may be more profitable. If we cannot successfully employ our vessels in profitable time charters our results of operations and operating cash flow could be adversely affected.

Table of Contents

We may be unable to make or realize expected benefits from acquisitions, and implementing our growth strategy through acquisitions may harm our business, financial condition and operating results.

Our growth strategy focuses on a gradual expansion of our fleet. Any acquisition of a vessel may not be profitable to us at or after the time we acquire it and may not generate cash flow sufficient to justify our investment. In addition, our growth strategy exposes us to risks that may harm our business, financial condition and operating results, including risks that we may:

- fail to realize anticipated benefits, such as new customer relationships, cost-savings or cash flow enhancements;
- be unable to hire, train or retain qualified shore and seafaring personnel to manage and operate our growing business and fleet;
- decrease our liquidity by using a significant portion of our available cash or borrowing capacity to finance acquisitions;
- significantly increase our interest expense or financial leverage if we incur additional debt to finance acquisitions;
- incur or assume unanticipated liabilities, losses or costs associated with the business or vessels acquired; or
- incur other significant charges, such as impairment of goodwill or other intangible assets, asset devaluation or restructuring charges.

If we purchase any newbuilding vessels, delays, cancellations or non-completion of deliveries of newbuilding vessels could harm our operating results.

If we purchase any newbuilding vessels, the shipbuilder could fail to deliver the newbuilding vessel as agreed or their counterparty could cancel the purchase contract if the shipbuilder fails to meet its obligations. In addition, under charters we may enter into that are related to a newbuilding, if our delivery of the newbuilding to our customer is delayed, we may be required to pay liquidated damages during the delay. For prolonged delays, the customer may terminate the charter and, in addition to the resulting loss of revenues, we may be responsible for additional, substantial liquidated damages.

The completion and delivery of newbuildings could be delayed, cancelled or otherwise not completed because of:

- quality or engineering problems;
- changes in governmental regulations or maritime self-regulatory organization standards;
- work stoppages or other labor disturbances at the shipyard;
- bankruptcy or other financial crisis of the shipbuilder;
- a backlog of orders at the shipyard;

- political or economic disturbances;
- weather interference or catastrophic event, such as a major earthquake or fire;
- requests for changes to the original vessel specifications;
- shortages of or delays in the receipt of necessary construction materials, such as steel;
- inability to finance the construction or conversion of the vessels; or
- inability to obtain requisite permits or approvals.

If delivery of a vessel is materially delayed, it could materially adversely affect our results of operations and financial condition and our ability to make cash distributions.

Table of Contents

The loss of a customer or charter could result in a loss of revenues and cash flow in the event we are unable to replace such customer, charter.

We have 15 charter counterparties. The three largest charter counterparties are Cosco Bulk Carrier Co. Ltd., Mitsui O.S.K. Lines, Ltd. and Samsun Logix and these charter counterparties accounted for approximately 22.2%, 18.5% and 13.2%, respectively, of total revenues for the year ended December 31, 2011. For the year ended December 31, 2010, the three largest charter counterparties were Mitsui O.S.K. Lines, Ltd., Cargill International S.A. and Cosco Bulk Carrier Co. Ltd., which accounted for 27.7%, 11.8% and 11.2% respectively, of total revenue. For the year ended December 31, 2009, the three largest charter counterparties were Mitsui O.S.K. Lines, Ltd., Cargill International S.A. and The Sanko Steamship Co. Ltd., which accounted for approximately 34.3%, 18.8% and 13.0% respectively, of total revenue. No other customers accounted for 10% or more of total revenue for any of the years presented.

We could lose a customer or the benefits of a charter if:

- the customer fails to make charter payments because of its financial inability, disagreements with us or otherwise;
- the customer exercises certain rights to terminate the charter;
- the customer terminates the charter because we fail to deliver the vessel within a fixed period of time, the vessel is lost or damaged beyond repair, there are serious deficiencies in the vessel or prolonged periods of off-hire, or we default under the charter; or
- a prolonged force majeure event affecting the customer, including damage to or destruction of relevant production facilities, war or political unrest prevents us from performing services for that customer.

If we lose a charter, we may be unable to re-deploy the related vessel on terms as favorable to us due to the long-term nature of most charters and the cyclical nature of the industry or we may be forced to charter the vessel on the spot market at then market rates which may be less favorable that the charter that has been terminated. If we are unable to re-deploy a vessel for which the charter has been terminated, we will not receive any revenues from that vessel, but we may be required to pay expenses necessary to maintain the vessel in proper operating condition.

The permanent loss of a customer or time charter, or a decline in payments under our charters, could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions in the event we are unable to replace such customer or time charter.

To mitigate the risk we have insured our charter-out contracts through a AA rated governmental agency of a European Union member state, which provides that if the charterer goes into payment default, the insurer will reimburse us for the charter payments under the terms of the policy (subject to applicable deductibles and other customary limitations for such insurance) for the remaining term of the charter-out contract.

In January 2011, Korea Line Corporation (KLC) which is the charterer of the Navios Melodia, filed for receivership. The charter contract was affirmed and will be performed by KLC on its original terms, provided that during an interim suspension period the sub-charterer pays Navios Partners directly.

The risks and costs associated with vessels increase as the vessels age.

As of March 5, 2012, the vessels in our fleet have an average age of approximately 5.7 years and most drybulk vessels have an expected life of approximately 25-28 years. We may acquire older vessels in the future. In some instances, charterers prefer newer vessels that are more fuel efficient than older vessels. Cargo insurance rates also increase with the age of a vessel, making older vessels less desirable to charterers as well. Governmental regulations, safety or other equipment standards related to the age of the vessels may require expenditures for alterations or the addition of new equipment, to our vessels and may restrict the type of activities in which these vessels may engage. We cannot assure you that as our vessels age, market conditions will justify those expenditures or enable us to operate our vessels profitably during the remainder of their useful lives. If we sell vessels, we may have to sell them at a loss, and if charterers no longer charter out vessels due to their age, it could materially adversely affect our earnings.

Vessels may suffer damage and we may face unexpected drydocking costs, which could affect our cash flow and financial condition.

If our owned vessels suffer damage, they may need to be repaired at a drydocking facility. The costs of drydock repairs are unpredictable and can be substantial. We may have to pay drydocking costs that insurance does not cover. The loss of earnings while these vessels are being repaired and repositioned, as well as the actual cost of these repairs, could decrease our revenues and earnings substantially, particularly if a number of vessels are damaged or drydocked at the same time. Under the terms of our management agreement with the Manager, only the costs of routine drydocking repairs are included in the daily management fee of $4,650 per owned Ultra-Handymax vessel, $4,550 per owned Panamax vessel and $5,650 per owned Capesize vessel, which are fixed until December 31, 2013. From January 1, 2013 to December 31, 2017, we expect that we will reimburse the Manager for all of the actual operating costs and expenses it incurs in connection with the management of our fleet.

We are subject to various laws, regulations and conventions, including environmental and safety laws that could require significant expenditures both to maintain compliance with such laws and to pay for any uninsured environmental liabilities including any resulting from a spill or other environmental incident.

The shipping business and vessel operation are materially affected by government regulation in the form of international conventions, national, state and local laws, and regulations in force in the jurisdictions in which vessels operate, as well as in the country or countries of their registration. Governmental regulations, safety or other equipment standards, as well as compliance with standards imposed by maritime self-regulatory organizations and customer requirements or competition, may require us to make capital and other expenditures. Because such conventions, laws and regulations are often revised, we cannot predict the ultimate cost of complying with such conventions, laws and regulations, or the impact thereof on the fair market price or useful life of our vessels. In order to satisfy any such requirements, we may be required to take any of our vessels out of service for extended periods of time, with corresponding losses of revenues. In the future, market conditions may not justify these expenditures or enable us to operate our vessels, particularly older vessels, profitably during the remainder of their economic lives. This could lead to significant asset write downs. In addition, violations of environmental and safety regulations can result in substantial penalties and, in certain instances, seizure or detention of our vessels.

Additional conventions, laws and regulations may be adopted that could limit our ability to do business, require capital expenditures or otherwise increase our cost of doing business, which may materially adversely affect our operations, as well as the shipping industry generally. In various jurisdictions legislation has been enacted, or is under consideration, that would impose more stringent requirements on air pollution and water discharges from our vessels. For example, the International Maritime Organization (IMO) periodically proposes and adopts amendments to revise the International Convention for the Prevention of Pollution from Ships (MARPOL), such as the revision to Annex VI which came into force on July 1, 2010. The revised Annex VI implements a phased reduction of the sulfur content of fuel and allows for stricter sulfur limits in designated emission control areas (ECAs). Thus far, ECAs have been formally adopted for the Baltic Sea and the North Sea including the English Channel. It is expected that waters off the North American coast will be established as an ECA from August 1, 2012, and the United States Caribbean Sea ECA will come into force on January 1, 2013, having effect from January 1, 2014. These ECAs will limit SOx, NOx and particulate matter emissions. In addition, the IMO, the U.S. and states within the U.S. have proposed or implemented requirements relating to the management of ballast water to prevent the harmful effects of foreign invasive species.

The operation of vessels is also affected by the requirements set forth in the International Safety Management (ISM) Code. The ISM Code requires shipowners and bareboat charterers to develop and maintain an extensive Safety Management System that includes the adoption of a safety and environmental protection policy setting forth instructions and procedures for safe vessel operation and describing procedures for dealing with emergencies. Further to this, the IMO is introducing the first ever mandatory measures for an international greenhouse gas reduction regime for a global industry sector. The measures will come into effect on January 1, 2013 and apply to all ships of 400 gross tonnage and above. They set a ship energy efficiency management plan (SEEMP) which is akin to a safety management plan, which the industry will have to comply with. The failure of a ship owner or bareboat charterer to comply with the ISM Code and IMO measures may subject such party to increased liability, may decrease available insurance coverage for the affected vessels, and may result in a denial of access to, or detention in, certain ports.

For all vessels, including those operated under our fleet, at present, international liability for oil pollution is governed by the International Convention on Civil Liability for Bunker Oil Pollution Damage (the Bunker Convention). In 2001, the IMO adopted the Bunker Convention, which imposes strict liability on shipowners for pollution damage and response costs incurred in contracting states caused by discharges, or threatened discharges, of bunker oil from all classes of ships. The Bunker Convention also requires registered owners of ships over a certain size to maintain insurance to cover their liability for pollution damage in an amount equal to the limits of liability under the applicable national or international limitation regime, including liability limits calculated in accordance with the Convention on Limitation of Liability for Maritime Claims 1976, as amended (the 1976 Convention), discussed in more detail in the following paragraph. The Bunker Convention became effective in contracting states on November 21, 2008 and as of January 3, 2012 was in effect in 64 states. In non-contracting states, liability for such bunker oil pollution typically is determined by the national or other domestic laws in the jurisdiction where the spillage occurs.

The Bunker Convention also provides vessel owners a right to limit their liability. The Bunker Convention incorporates the 1976 Convention referenced above. The 1976 Convention is the most widely applicable international regime limiting maritime pollution liability. Rights to limit liability under the 1976 Convention are forfeited where a spill is caused by a shipowner s intentional or reckless conduct. Certain jurisdictions have ratified the IMO s Protocol of 1996 to the 1976 Convention, referred to herein as the Protocol of 1996. The Protocol of 1996 provides for substantially higher liability limits in those jurisdictions than the limits set forth in the 1976 Convention. Finally, some jurisdictions, such as the

United States, are not a party to either the 1976 Convention or the Protocol of 1996, and, therefore, a shipowner s rights to limit liability for maritime pollution in such jurisdictions may be uncertain.

Table of Contents

Environmental legislation in the United States merits particular mention as it is in many respects more onerous than international laws, representing a high-water mark of regulation with which ship owners and operators must comply, and of liability likely to be incurred in the event of non-compliance or an incident causing pollution. Such regulation may become even stricter if laws are changed as a result of the April 2010 Deepwater Horizon oil spill in the Gulf of Mexico. In the United States, the OPA establishes an extensive regulatory and liability regime for the protection and cleanup of the environment from cargo and bunker oil spills from vessels, including tankers. The OPA covers all owners and operators whose vessels trade in the United States, its territories and possessions or whose vessels operate in United States waters, which includes the United States territorial sea and its 200 nautical mile exclusive economic zone. Under the OPA, vessel owners, operators and bareboat charterers are responsible parties and are jointly, severally and strictly liable (unless the spill results solely from the act or omission of a third party, an act of God or an act of war) for all containment and clean-up costs and other damages arising from discharges or substantial threats of discharges, of oil from their vessels. In response to the 2010 Deepwater Horizon oil incident in the Gulf of Mexico, the U.S. House of Representatives passed and the U.S. Senate considered but did not pass a bill to strengthen certain requirements of the OPA; similar legislation may be introduced in the future 112th Congress.

In addition to potential liability under the federal OPA, vessel owners may in some instances incur liability on an even more stringent basis under state law in the particular state where the spillage occurred. For example, California regulations prohibit the discharge of oil, require an oil contingency plan be filed with the state, require that the ship owner contract with an oil response organization and require a valid certificate of financial responsibility, all prior to the vessel entering state waters.

In the last decade, the EU has become increasingly active in the field of regulation of maritime safety and protection of the environment. In some areas of regulation the EU has introduced new laws without attempting to procure a corresponding amendment to international law. Notably, the EU adopted in 2005 a directive, as amended in 2009, on ship-source pollution, imposing criminal sanctions for pollution not only where pollution is caused by intent or recklessness (which would be an offence under MARPOL), but also where it is caused by serious negligence. The concept of serious negligence may be interpreted in practice to be little more than ordinary negligence. The directive could therefore result in criminal liability being incurred in circumstances where it would not be incurred under international law. Criminal liability for a pollution incident could not only result in us incurring substantial penalties or fines, but may also, in some jurisdictions, facilitate civil liability claims for greater compensation than would otherwise have been payable.

We maintain insurance coverage for each owned vessel in our fleet against pollution liability risks in the amount of $1.0 billion in the aggregate for any one event. The insured risks include penalties and fines as well as civil liabilities and expenses resulting from accidental pollution. However, this insurance coverage is subject to exclusions, deductibles and other terms and conditions. If any liabilities or expenses fall within an exclusion from coverage, or if damages from a catastrophic incident exceed the aggregate liability of $1.0 billion for any one event, our cash flow, profitability and financial position would be adversely impacted.

Climate change and government laws and regulations related to climate change could negatively impact our financial condition.

Regarding climate change in particular, we are and will be, directly and indirectly, subject to the effects of climate change and may, directly or indirectly, be affected by government laws and regulations related to climate change. A number of countries have adopted or are considering the adoption of, regulatory frameworks to reduce greenhouse gas emissions. In the U.S., the United States Environmental Protection Agency (U.S. EPA) has declared greenhouse gases to be dangerous pollutants and has issued greenhouse gas reporting requirements for emissions sources in certain industries (which do not include the shipping industry). The U.S. EPA is also considering petitions to regulate greenhouse gas emissions from marine vessels.

In addition, while the emissions of greenhouse gases from international shipping are not subject to the Kyoto Protocol to the United Nations Framework Convention on Climate Change, which requires adopting countries to implement national programs to reduce greenhouse gas emissions, the IMO intends to develop limits on greenhouse gases from international shipping. It has responded to the global focus on climate change and greenhouse gas emissions by developing specific technical and operational efficiency measures and a work plan for market-based mechanisms in 2011. These include the mandatory measures of the ship energy efficiency management plan (SEEMP), outlined above, and an energy efficiency design index (EEDI) for new ships. The IMO is also considering its position on market-based measures through an expert working group, which will report back to its Marine Environment Protection Committee (M Mitsui O.S.K. Lines, Ltd., Cargill International S.A., Cosco Bulk Carrier Co. Ltd., Samsun Logix and The Sanko Steamship Co. Ltd.EPC) later this year. Among the numerous proposals being considered by the working group are the following: a port state levy based on the amount of fuel consumed by the vessel on its voyage to the port in question; a global emissions trading scheme which would allocate emissions allowances and set an emissions cap; and an international fund establishing a global reduction target for international shipping, to be set either by the UNFCCC or the IMO. In December 2011, UN climate change talks took place in Durban and concluded with an agreement referred to as the Durban Platform for Enhanced Action.

17

Table of Contents

The Durban Conference did not result in any proposals specifically addressing the shipping industry s role in climate change but the progress that has been made by the IMO in this area was widely acknowledged throughout the negotiating bodies of the UNFCCC process.

The European Union announced in April 2007 that it planned to expand the European Union emissions trading scheme by adding vessels, and a proposal from the European Commission was expected if no global regime for reduction of seaborne emissions had been agreed to by the end of 2011. That deadline has now expired and it remains to be seen what position the EU takes in this regard in 2012.

We cannot predict with any degree of certainty what effect, if any, possible climate change and government laws and regulations related to climate change will have on our operations, whether directly or indirectly. While we believe that it is difficult to assess the timing and effect of climate change and pending legislation and regulation related to climate change on our business, we believe that climate change, including the possible increase in severe weather events resulting from climate change, and government laws and regulations related to climate change may affect, directly or indirectly, (i) the cost of the vessels we may acquire in the future, (ii) our ability to continue to operate as we have in the past, (iii) the cost of operating our vessels, and (iv) insurance premiums, deductibles and the availability of coverage. As a result, our financial condition could be negatively impacted by significant climate change and related governmental regulation, and that impact could be material.

The loss of key members of our senior management team could disrupt the management of our business.

We believe that our success depends on the continued contributions of the members of our senior management team, including Ms. Angeliki Frangou, our Chairman and Chief Executive Officer. The loss of the services of Ms. Frangou or one of our other executive officers or those of Navios Holdings who provide us with significant managerial services could impair our ability to identify and secure new charter contracts, to maintain good customer relations and to otherwise manage our business, which could have a material adverse effect on our financial performance and our ability to compete.

We are subject to vessel security regulations and will incur costs to comply with recently adopted regulations and we may be subject to costs to comply with similar regulations that may be adopted in the future in response to terrorism.

Since the terrorist attacks of September 11, 2001, there have been a variety of initiatives intended to enhance vessel security. On November 25, 2002, the Maritime Transportation Security Act of 2002, or MTSA, came into effect. To implement certain portions of the MTSA, in July 2003, the U.S. Coast Guard issued regulations requiring the implementation of certain security requirements aboard vessels operating in waters subject to the jurisdiction of the United States. Similarly, in December 2002, amendments to the International Convention for the Safety of Life at Sea, or SOLAS, created a new chapter of the convention dealing specifically with maritime security. The new chapter went into effect in July 2004, and imposes various detailed security obligations on vessels and port authorities, most of which are contained in yle="border-top: 1px solid #000000">

Total liabilities
$1,241 $ $1,241 $

The Corporation used the following methods and significant assumptions to estimate the fair value.

Investment securities: Level 1 securities represent equity securities that are valued using quoted market prices from nationally recognized markets. Level 2 securities represent debt securities that are valued using a mathematical model based upon the specific characteristics of a security in relationship to quoted prices for similar securities.

Interest rate swaps: The interest rate swaps are valued using a discounted cash flow model that uses verifiable market environment inputs to calculate the fair value. This method is not dependant on the input of any significant judgments or assumptions by Management.

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2009 are as follows:

(Dollars in Thousands)	**Fair Value at June 30, 2009**	**Level 1**	**Level 2**	**Level 3**
Asset Description				
Impaired loans	$ 14,603	$	$	$ 14,603
Other real estate owned	413			413
Mortgage servicing rights	794			794
Total assets	$ 15,810	$	$	$ 15,810

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Corporation s financial instruments at June 30, 2009:

Cash and Cash Equivalents:

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Investment securities:

The fair value of investment securities is determined in accordance with the methods described under SFAS 157, *Fair Value Measurements*.

Loans, net:

The fair value of fixed-rate loans is estimated for each major type of loan (e.g. real estate, commercial, industrial and agricultural and consumer) by discounting the future cash flows associated with such loans using rates currently offered for loans with similar terms to borrowers of comparable credit quality. The model considers scheduled principal maturities, repricing characteristics, prepayment assumptions and interest cash flows. The discount rates used are estimated based upon consideration of a number of factors including the treasury yield curve, expense and service charge factors. For variable rate loans that reprice frequently and have no significant change in credit quality, carrying values approximate the fair value.

Accrued interest receivable:

The carrying amount is a reasonable estimate of fair value.

Mortgage servicing rights:

The fair value of mortgage servicing rights is based on observable market prices when available or the present value of expected future cash flows when not available. Assumptions, such as loan default rates, costs to service, and prepayment speeds significantly affect the estimate of future cash flows. Mortgage servicing rights are carried at the lower of cost or fair value.

Deposits:
The fair value of demand deposits, savings accounts, and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-rate certificates of deposit is estimated by discounting the future cash flows using rates approximating those currently offered for certificates of deposit with similar remaining maturities.
Securities sold under agreements to repurchase:
The carrying amount is a reasonable estimate of fair value.
Short-term borrowings:
The carrying amount is a reasonable estimate of fair value.
Long-term debt:
The fair value of long-term debt is estimated by discounting the future cash flows using rates approximating those currently offered for borrowings with similar remaining maturities.
Accrued interest payable:
The carrying amount is a reasonable estimate of fair value.
Interest rate swaps:
The fair value of the interest rate swaps is determined in accordance with the methods described under SFAS 157, *Fair Value Measurements.*
Off balance sheet financial instruments:
Outstanding commitments to extend credit and commitments under standby letters of credit include fixed and variable rate commercial and consumer commitments. The fair value of the commitments is estimated using the fees currently charged to enter into similar agreements.
The estimated fair value of the Corporation s financial instruments at June 30 are as follows:

	2009		**2008**	
(Amounts in thousands)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:				
Cash and equivalents	**$ 55,269**	**$ 55,269**	**$ 16,713**	**$ 16,713**
Investment securities available for sale	**147,324**	**147,324**	**147,559**	**147,559**
Restricted stock	**6,482**	**6,482**	**6,482**	**6,482**
Net loans	**695,488**	**703,004**	**668,860**	**692,239**
Accrued interest receivable	**3,731**	**3,731**	**3,751**	**3,751**
Mortgage servicing rights	**794**	**794**	**863**	**863**
Financial liabilities:				
Deposits	**$ 709,993**	**$ 714,604**	**$ 627,341**	**$ 626,909**
Securities sold under agreements to repurchase	**65,016**	**65,016**	**64,312**	**64,312**
Short-term borrowings			**18,850**	**18,850**
Long-term debt	**103,441**	**106,189**	**106,141**	**111,193**
Accrued interest payable	**1,340**	**1,340**	**1,481**	**1,481**
Interest rate swaps	**1,241**	**1,241**	**2,477**	**2,477**
Off Balance Sheet financial instruments:				
Commitments to extend credit				
Standby letters-of-credit				

Table of Contents

Note 8 Financial Derivatives

The Board of Directors has given Management authorization to enter into derivative activity including interest rate swaps, caps and floors, forward-rate agreements, options and futures contracts in order to hedge interest rate risk. The Bank is exposed to credit risk equal to the positive fair value of a derivative instrument, if any, as a positive fair value indicates that the counterparty to the agreement is financially liable to the Bank. To limit this risk, counterparties must have an investment grade long-term debt rating and individual counterparty credit exposure is limited by Board approved parameters. Management anticipates continuing to use derivatives, as permitted by its Board-approved policy, to manage interest rate risk. During 2008, the Bank entered into two interest rate swap transactions in order to hedge the Corporation s exposure to changes in cash flows attributable to the effect of interest rate changes on variable rate liabilities.

Information regarding the interest rate swap as of June 30, 2009 follows:

(Dollars in thousands) Notional Amount	Maturity Date	Interest Rate Fixed	Interest Rate Variable	Amount Expected to be Expensed into Earnings within the next 12 Months
$10,000	**5/30/2013**	**3.60%**	**0.20%**	**$ 340**
$10,000	**5/30/2015**	**3.87%**	**0.20%**	**$ 367**

The variable rate is indexed to the 91-day Treasury Bill auction (discount) rate and resets weekly.

Derivatives with a positive fair value are reflected as other assets in the balance sheet while those with a negative fair value are reflected as other liabilities. The swaps added $350 thousand to interest expense in the first six months of 2009. As short-term interest rates decrease, the net expense of the swap increases. As short-term rates increase, the net expense of the swap decreases.

Fair Value of Derivative Instruments in the Consolidated Balance Sheets were as follows as of June 30, 2009:

Fair Value of Derivative Instruments Designated as Hedging Instruments Under Statement 133

	Liability Derivatives 6/30/2009	
(Dollars in thousands) Type	Balance Sheet Location	Fair Value
Interest rate contracts	**Other liabilities**	**$ 1,241**

18

Table of Contents

The Effect of Derivative Instruments on the Statement of Financial Performance for the Six Months Ended June 30, 2009 follows:

Derivatives in Statement 133 Cash Flow Hedging Relationships

(Dollars in thousands) **Type**	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) **6/30/2009**	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) **6/30/2009**	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing **6/30/2009**
Interest rate contracts	**$ 815**	**Interest Expense**	**$ (350)**	**Other income (expense)**	**$**

Note 9 Subsequent Events

Subsequent events have been evaluated for potential recognition and/or disclosure through August 10, 2009, the date the consolidated financial statements were issued. The following information is disclosed as a nonrecognized subsequent event:

The Bank owns two debt securities issued by CIT Group, Inc (CIT). One security is $2 million and matures on August 17, 2009 and the other is $1 million and matures November 3, 2010.

In early July 2009, news from CIT indicated that it may have insufficient liquidity to cover the approximately $1 billion in bonds due on August 17, 2009. As a Bank Holding Company and recipient of $2.3 billion in Troubled Asset Relief Program (TARP) funds in September 2008, CIT quickly began discussions with federal regulators in July 2009 about additional government support. On July 15, 2009, CIT announced that it had been advised that there is no appreciable likelihood of additional government support being provided in the near term. Since that time, CIT has been in negotiation with private firms to obtain short-term funding. On July 21, 2009, CIT announced a discount tender offer of $875 per $1,000 principal for the August 17, 2009 bonds. The Bank has submitted its acceptance of the tender offer. If the tender offer is successfully completed, the Bank will recognize a pretax loss of $250 thousand. If the tender offer is not successfully completed, it is possible that CIT may declare bankruptcy and the Bank would recognize a substantially larger loss on its August 17, 2009 bond.

The value of the November 3, 2010 bond will be, in part, determined by the success of the August 2009 tender offer, CIT s ability to obtain additional funding and its decision whether or not to file bankruptcy. It is possible that the Bank may recognize a loss on this bond prior to maturity.

Note 10 Reclassifications

Certain prior period amounts may have been reclassified to conform to the current year presentation. Such reclassifications did not affect reported net income.

Table of Contents

Part I, Item 2

Management s Discussion and Analysis of Results of Operations and Financial Condition
For the Three and Six Month Periods Ended June 30, 2009 and 2008

Forward Looking Statements

Certain statements appearing herein which are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements refer to a future period or periods, reflecting management s current views as to likely future developments, and use words such as may, will, expect, believe, estimate, anticipate, or similar terms. Because forward-looking statements involve certain uncertainties and other factors over which the Corporation has no direct control, actual results could differ materially from those contemplated in such statements. These factors include (but are not limited to) the following: general economic conditions, changes in interest rates, changes in the Corporation s cost of funds, changes in government monetary policy, changes in government regulation and taxation of financial institutions, changes in the rate of inflation, changes in technology, the intensification of competition within the Corporation s market area, and other similar factors.

Critical Accounting Policies

Management has identified critical accounting policies for the Corporation to include Allowance for Loan Losses, Mortgage Servicing Rights, Financial Derivatives, Temporary Investment Impairment and Stock-based Compensation. There were no changes to the critical accounting policies disclosed in the 2008 Annual Report on Form 10-K in regards to application or related judgements and estimates used. Please refer to Item 7 of the Corporation s 2008 Annual Report on Form 10-K for a more detailed disclosure of the critical accounting policies.

Results of Operations

Year-to-Date Summary

The Corporation reported net income for the six months ended June 30, 2009 of $3.7 million. This is a 25% decrease versus net income of $5.0 million for the same period in 2008. Total revenue (interest income and noninterest income) decreased $715 thousand year-over-year, due primarily to the lower interest rate environment and its negative effect on interest income. The provision for loan losses was $1.0 million for the period, $514 thousand more than in 2008. Diluted earnings per share decreased to $.98 in 2009 from $1.30 in 2008. Total assets were $966.7 million at June 30, 2009, an increase of $64.2 million from year-end 2008. Net loans grew during the quarter with an ending balance of $695.5 million, while total deposits grew to $710.0 million.

Other key performance ratios as of, or for the six months ended June 30, 2009 (on an annualized basis) are listed below:

	2009	2008
Return on average equity (ROE)	**9.99%**	12.51%
Return on average assets (ROA)	**.80%**	1.19%
Return on average tangible average equity(1)	**12.54%**	15.21%
Return on average tangible average assets(1)	**.86%**	1.25%
Efficiency Ratio	**65.09%**	59.53%

Table of Contents

(1) The Corporation supplements its traditional GAAP measurements with Non-GAAP measurements. The Non-GAAP measurements include Return on Average Tangible Assets and Return on Average Tangible Equity. The purchase method of accounting was used to record the acquisition of Fulton Bancshares Corporation. As a result, intangible assets (primarily goodwill and core deposit intangibles) were created. The Non-GAAP disclosures are intended to eliminate the effects of the intangible assets and allow for better comparisons to periods when such assets did not exist. The following table shows the adjustments made between

the GAAP and
NON-GAAP
measurements:

GAAP Measurement	Calculation
Return on Average Assets	Net Income / Average Assets
Return on Average Equity	Net Income / Average Equity

Non- GAAP Measurement	Calculation
Return on Average Tangible Assets	Net Income plus Intangible Amortization /Average Assets less Average Intangible Assets
Return on Average Tangible Equity	Net Income plus Intangible Amortization /Average Equity less Average Intangible Assets
Efficiency Ratio	Noninterest Expense / Tax Equivalent Net Interest Income plus Noninterest Income (excluding Security Gains/Losses and Other Than Temporary Impairment)

A more detailed discussion of the operating results for the three and six months ended June 30, 2009 follows:

Comparison of the three months ended June 30, 2009 to the three months ended June 30, 2008:

Net Interest Income

The most important source of the Corporation s earnings is net interest income, which is defined as the difference between income on interest-earning assets and the expense of interest-bearing liabilities supporting those assets. Principal categories of interest-earning assets are loans and securities, while deposits, securities sold under agreements to repurchase (Repos), short-term borrowings and long-term debt are the principal categories of interest-bearing liabilities. Demand deposits enhance net interest income because they are noninterest-bearing deposits. All balance sheet amounts in the discussion of net interest income refer to either year-to-date or quarterly average balances.

Interest income for the second quarter of 2009 decreased to $11.0 million from $11.2 million during the second quarter of 2008. Average interest-earning assets increased by $109.6 million from the second quarter of 2008, however the yield on these assets decreased by 89 basis points. The average balance on investment securities decreased $10.6 million quarter over quarter due to pay downs and maturities in the portfolio, net of investment purchases. Total average loans increased $101.9 million (16.9%) quarter over quarter. Average commercial loans increased $114.7 million during the first half of 2009, but the increase was partially offset by a decrease of $11.3 million in average outstanding mortgage loans, as the mortgage portfolio continues to runoff. Average consumer loans decreased $8.5 million, as consumers continue to react to the adverse changes in the economy.

Interest expense was $3.6 million for the second quarter, a decrease of $152 thousand from the second quarter of 2008 total of $3.8 million. Average interest-bearing liabilities increased to $776.9 million in the second quarter of 2009 compared to an average balance of $663.3 million during the same period in 2008, an increase of $113.5 million. The average cost of these liabilities decreased from 2.29% to 1.87%. Average interest-bearing deposits increased $93.9 million and the cost decreased from 2.06% to 1.69%. Securities sold under agreements to repurchase (Repos) have decreased $4.2 million on average over the prior year second quarter and the average rate has decreased from 1.84% to .25%. The average balance of long-term debt increased over $32.3 million due to the Bank taking additional advances from the Federal Home Loan Bank of Pittsburgh (FHLB) and was the primary reason for the increase in interest expense for this liability.

The changes in the balance sheet and interest rates resulted in a decrease in net interest income of $104 thousand to $7.4 million for the second quarter of 2009 compared to $7.5 million for the second quarter of 2008. The Bank s net interest margin decreased from 4.07% for the second quarter of 2008 to 3.49% in the second quarter of 2009. The decrease in the net interest margin is due to the yield on interest-bearing assets (mainly variable rate commercial loans) decreasing 89 basis points, while the yield on interest-earning liabilities only decreased 42 basis points.

The following table shows a comparative analysis of average balances, asset yields and funding costs for the three months ended June 30, 2009 and 2008. These components drive changes in net interest income.

	For the Three Months Ended June 30					
	2009			2008		
(Dollars in thousands)	**Average balance**	**Tax Equivalent Interest**	**Average yield/rate**	Average balance	Tax Equivalent Interest	Average yield/rate
Interest-earning assets						
Federal funds sold and interest-bearing balances	**$ 19,397**	**$ 7**	**0.14%**	$ 1,014	$ 6	2.37%
Investment securities	**151,333**	**1,729**	**4.57%**	161,969	2,085	5.15%
Loans	**705,369**	**9,524**	**5.38%**	603,482	9,467	6.26%
Total interest-earning assets	**$ 876,099**	**11,260**	**5.16%**	$ 766,465	11,558	6.05%
Interest-bearing liabilities						
Interest-bearing deposits	**$ 600,068**	**2,535**	**1.69%**	$ 506,206	2,597	2.06%
Securities sold under agreements to repurchase	**72,178**	**45**	**0.25%**	76,337	350	1.84%
Short-term borrowings				8,461	49	2.32%
Long-term debt	**104,639**	**1,050**	**4.02%**	72,335	786	4.36%
Total interest-bearing liabilities	**$ 776,885**	**3,630**	**1.87%**	$ 663,339	3,782	2.29%
Interest spread			**3.29%**			3.76%
Tax equivalent Net interest income/Net interest margin		**7,630**	**3.49%**		7,776	4.07%
Tax equivalent adjustment		**(271)**			(313)	
Net interest income		**$ 7,359**			$ 7,463	

All amounts have been adjusted to a tax-equivalent basis using a tax rate of 34%. Investments include the average unrealized gains or losses. Dividend income is reported as taxable income but is adjusted for the dividend received deduction. Loan balances include nonaccruing loans, loans held for sale, and are gross of the allowance for loan losses.

Provision for Loan Losses

For the second quarter of 2009, provision expense was $426 thousand versus $290 thousand for the same period in 2008. For more information concerning loan quality and the allowance for loan losses, refer to the Financial Condition section of Management s Dicussion and Analysis.

22

Noninterest Income

For the three months ended June 30, 2009, noninterest income increased $126 thousand to $2.4 million, compared to $2.2 million for the second quarter of 2008. Investment and trust service fees increased due to the addition of trust accounts from the acquisition of Community Financial, Inc. in late 2008 and helped to offset the declining market value of trust assets under management. The increase in loan service charges was primarily due to the continued high volume of mortgage originations driven by the low rate environment. Mortgage banking fees were down quarter to quarter due to an increase in mortgage servicing rights (MSR) amortization expense and a smaller reversal of previously recorded MSR impairment charges. Account analysis fees are the primary reason for the increase in deposit service charges and fees, as lower market interest rates produced lower earnings credits for commercial account analysis customers and therefore, higher account charges. Other service charges also increased in 2009, due to an increase in debit card and check order income. Equity method investment income was $0 for 2009. During 2008, the Corporation had an investment in American Home Bank, N.A (AHB) that was accounted for using the equity method of accounting. This investment produced income of $44 thousand in the second quarter of 2008. On December 31, 2008, First Chester County Corporation (FCEC) completed its acquisition of AHB. The Corporation discontinued the equity method of accounting on this investment and no income was recognized in 2009. Other income increased in the second quarter of 2009 due to higher title insurance income. Gains on sales of securities totaled $42 thousand for the quarter versus $0 in the same quarter in the prior year. The Corporation took an other than temporary impairment charge of $212 thousand on one bank stock in its equity portfolio in the second quarter of 2009.

	For the Three Months Ended June 30		Change	
	2009	2008	Amount	%
Noninterest Income				
Investment and trust services fees	$ 862	$ 845	$ 17	2.0
Loan service charges	383	225	158	70.2
Mortgage banking activities	113	245	(132)	(53.9)
Deposit service charges and fees	653	633	20	3.2
Other service charges and fees	339	314	25	8.0
Increase in cash surrender value of life insurance	160	166	(6)	(3.6)
Equity method investment		44	(44)	(100.0)
Other	29	(18)	47	(261.1)
Impairment writedown on equity securities	(212)	(211)	(1)	0.5
Gains on sale of securities, net	42		42	
Total noninterest income	$ 2,369	$ 2,243	$ 126	5.6

Noninterest Expense

Noninterest expense for the second quarter of 2009 totaled $7.0 million compared to $6.0 million in the second quarter of 2008. The increase in salaries and benefits was due primarily to pension expense of $127 thousand, compared to pension income of $5 thousand in the same period in 2008. The increase in pension expense is the result of the low rate environment and its affect on pension plan performance and pension obligations. The addition of the Camp Hill office was the main cause of the increase in net occupancy and furniture and equipment expense. Advertising expense decreased in the second quarter of 2009, as the same quarter in 2008 contained production fees for a customer education website that was completed in 2008. Legal fees and data processing fees increased moderately over the same period in 2008. The increase in intangible amortization is due to the acquisition of Community Financial, Inc. in the fourth quarter of 2008. FDIC Insurance increased $596 thousand due to the $450 thousand FDIC special assessment (payable September 30, 2009) and an increase in the 2009 assessment rates. Also, the FDIC expense in 2008 was partially offset by the use of FDIC premium credits. The increase in other expenses was primarily the result of a prepayment penalty on a high-rate term loan from the FHLB and the write-down of leasehold improvements from closing a branch location in the second quarter.

	For the Three Months Ended June 30		Change	
	2009	2008	Amount	%
Noninterest Expense				
Salaries and benefits	$ 3,126	$ 2,982	$ 144	4.8
Net occupancy expense	476	450	26	5.8
Furniture and equipment expense	213	210	3	1.4
Advertising	418	455	(37)	(8.1)
Legal & professional fees	293	276	17	6.2
Data processing	435	413	22	5.3
Pennsylvania bank shares tax	143	167	(24)	(14.4)
Intangible amortization	117	90	27	30.0
FDIC insurance	683	87	596	685.1
Other	1,062	903	159	17.6
Total noninterest expense	$ 6,966	$ 6,033	$ 933	15.5

Income taxes

Federal income tax expense was $697 thousand for the second quarter of 2009 compared to $932 thousand in 2008. The effective tax rate for the second quarter of 2009 was 29.8% and 27.5% for 2008. All taxable income for the Corporation is taxed at a rate of 34%.

Comparison of the six months ended June 30, 2009 to the six months ended June 30, 2008:

Net Interest Income

Interest income for the first six months of 2009 decreased to $21.8 million from $22.9 million during the first six months of 2008. Average interest-earning assets increased by $96.6 million from the first half of 2008, however the yield on these assets decreased by 93 basis points. The average balance on investment securities decreased $12.5 million quarter over quarter due to pay downs and maturities in the portfolio, net of investment purchases. Total average loans increased $101.5 million (17.2%) year over year. Average commercial loans increased $114.7 million during the first six months of 2009, but the increase was partially offset by a decrease of $11.3 million in average outstanding mortgage loans, as the mortgage portfolio continues to runoff. Average consumer loans decreased only slightly, $1.9 million, as consumers continue to react to the adverse changes in the economy.

Interest expense was $7.2 million for the first half of 2009, a decrease of $726 thousand from the first half 2008 total of $8.0 million. Average interest-bearing liabilities increased to $755.5 million in the first six months of 2009 compared to an average balance of $655.7 million during the same period in 2008, an increase of $99.8 million. The average cost of these liabilities decreased from 2.44% to 1.93%, as liability rates followed the downward trend of market rates. Average interest-bearing deposits increased $68.0 million, but the cost decreased from 2.16% to 1.76%. Securities sold under agreements to repurchase (Repos) have decreased $4.6 million on average over the prior year and the average rate decreased from 2.50% to .25%. The average balance of long-term debt increased over $38.2 million due to the Bank taking additional low-rate advances in 2008 from FHLB and was the primary reason for the increase in interest expense for this liability.

Table of Contents

The changes in the balance sheet and interest rates resulted in a decrease in net interest income of approximately $399 thousand to $14.6 million for the first six months of 2009 compared to $15.0 million for the same period in 2008. The Bank s net interest margin decreased from 4.10% for the first half of 2008 to 3.54% in the first half of 2009. The decrease in the net interest margin is due to the yield on interest-bearing assets decreasing 93 basis points (mainly variable rate commercial loans), while the yield on interest-earning liabilities only decreased 51 basis points.
The following table shows a comparative analysis of average balances, asset yields and funding costs for the six months ended June 30, 2009 and 2008. These components drive changes in net interest income.

	For the Six Months Ended June 30					
		2009			2008	
(Dollars in thousands)	**Average balance**	**Tax Equivalent Interest**	**Average yield/rate**	Average balance	Tax Equivalent Interest	Average yield/rate
Interest-earning assets						
Federal funds sold and interest-bearing balances	**$ 10,011**	**$ 7**	**0.14%**	$ 2,370	$ 41	3.42%
Investment securities	**151,594**	**3,563**	**4.70%**	164,123	4,344	5.29%
Loans	**692,160**	**18,779**	**5.43%**	590,631	19,177	6.48%
Total interest-earning assets	**$ 853,765**	**22,349**	**5.28%**	$ 757,124	23,562	6.21%
Interest-bearing liabilities						
Interest-bearing deposits	**$ 574,725**	**5,018**	**1.76%**	$ 506,711	5,452	2.16%
Securities sold under agreements to repurchase	**72,238**	**90**	**0.25%**	76,866	958	2.50%
Short-term borrowings	**3,342**	**11**	**0.66%**	5,123	63	2.47%
Long-term debt	**105,215**	**2,105**	**4.03%**	66,992	1,477	4.42%
Total interest-bearing liabilities	**$ 755,520**	**7,224**	**1.93%**	$ 655,692	7,950	2.44%
Interest spread			**3.35%**			3.77%
Tax equivalent Net interest income/Net interest margin		**15,125**	**3.54%**		15,612	4.10%
Tax equivalent adjustment		**(548)**			(636)	
Net interest income		**$ 14,577**			$ 14,976	

All amounts have been adjusted to a tax-equivalent basis using a tax rate of 34%. Investments include the average unrealized gains or losses. Dividend income is reported as taxable income but is adjusted for the dividend received deduction. Loan balances include nonaccruing loans, loans held for sale, and are gross of the allowance for loan losses.

Provision for Loan Losses

The Corporation recorded $1.0 million in provision expense during the first six months of 2009 versus $505 thousand for the same period in 2008. For more information concerning loan quality and the allowance for loan losses, refer to the Financial Condition section of Management s Discussion and Analysis.

25

Table of Contents

Noninterest Income

Noninterest income was $4.7 million in the first six months of 2009, $410 thousand more than the first six months of 2008 total of $4.2 million. Investment and trust service fees remained flat, as the addition of accounts from the acquisition of Community Financial, Inc. helped offset the decrease in market value of assets under management. Loan fees increased by $257 thousand due to a high volume of mortgage originations driven by the low rate environment. Mortgage banking fees decreased $51 thousand due to an increase in mortgage servicing rights (MSR) amortization expense partially offset by a reversal of previously recorded MSR impairment charges. Deposit fees were flat; however, the composition of deposit fees changed year over year. The Bank recorded less fee income from its overdraft protection program, but higher fees from commercial cash management services. Other service charges and fees increased primarily due to check order income. During 2008, the Corporation had an investment in American Home Bank, N.A (AHB) that was accounted for using the equity method of accounting. This investment produced a loss of $122 thousand in the first six months of 2008. On December 31, 2008, First Chester County Corporation (FCEC) completed its acquisition of AHB. The Corporation discontinued the equity method of accounting on this investment and no income was recognized in 2009. Other income increased $322 thousand due to income from the benefits on a life insurance policy ($276 thousand) in 2009. Net securities gains of $54 thousand were recognized in the first half of 2009, compared to $329 thousand in 2008. For the first six months of 2009, the Corporation took write-downs of $421 thousand on four equity securities it considered to be temporarily impaired as compared to $432 thousand the previous year.

The following table provides more information about noninterest income:

	For the Six Months Ended June 30		Change	
	2009	2008	Amount	%
Noninterest Income				
Investment and trust services fees	$ 1,757	$ 1,760	($3)	(0.2)
Loan service charges	659	402	257	63.9
Mortgage banking activities	85	136	(51)	(37.5)
Deposit service charges and fees	1,232	1,226	6	0.5
Other service charges and fees	641	613	28	4.6
Increase in cash surrender value of life insurance	324	331	(7)	(2.1)
Equity method investment		(122)	122	(100.0)
Other	325	3	322	10,733.3
Impairment writedown on equity securities	(421)	(432)	11	(2.5)
Gains (losses) on sale of securities, net	54	329	(275)	(83.6)
Total noninterest income	$ 4,656	$ 4,246	$ 410	9.7

Noninterest Expense

During the first half of 2009, noninterest expense increased $1.2 million to $13.1 million from $11.9 million in 2008. Salaries and benefits increased $196 thousand primarily due to an increase in pension expense in 2009 of $255 thousand compared to pension income of $21 thousand in the same period in 2008. The increase in pension expense is the result of the low rate environment and its affect on pension plan performance and pension obligations. Advertising expense decreased $35 thousand in 2009 due to expenses in 2008 for the production of a customer education website that was completed in 2008. Data processing expenses were up $66 thousand due to the implementation of remote deposit capture and electronic check presentment services. Intangible amortization increased $53 thousand from the amortization of the customer list intangible asset booked with the acquisition of Community Financial, Inc. in the fourth quarter of 2008. Other noninterest expense increased $121 thousand during the first six months due to a prepayment penalty on a high-rate term loan from the FHLB and the write-down of leasehold improvements from closing a branch location in the second quarter.

FDIC insurance expense increased $809 thousand during the first half of 2009 to $914 thousand compared to $105 thousand for the same period in 2008 due to a $450 thousand FDIC special assessment (payable September 30, 2009) and an increase in the 2009 assessment rates. The FDIC insurance expense in the first six months of 2008 was partially offset by the use of FDIC premium credits. These credits were completely used in 2008. An additional special assessment by the FDIC of up to 5 basis points is possible later in 2009.

The Bank is a member of the Deposit Insurance Fund (the DIF), which is administered by the FDIC. Deposit accounts at the Bank are insured by the FDIC, generally up to a maximum of $100,000 for each separately insured depositor and up to a maximum of $250,000 for self-directed retirement accounts. However, the FDIC increased the deposit insurance available on all deposit accounts to $250,000, effective until December 31, 2009. In addition, certain noninterest-bearing transaction accounts maintained with financial institutions participating in the FDIC s Transaction Account Guarantee Program (TAG) are fully insured regardless of the dollar amount until December 31, 2013. Under the TAG, an annualized 10 basis point assessment on balances in noninterest-bearing transaction accounts that exceed the existing deposit insurance limit of $250,000 will be assessed on a quarterly basis to insured depository institutions that have not opted out of this component of the Temporary Liquidity Guarantee Program. The Bank has opted to participate in the Transaction Account Guaranteed Program.

The following table provides more information about noninterest expense:

	For the Six Months Ended June 30		Change	
	2009	2008	Amount	%
Noninterest Expense				
Salaries and benefits	$ 6,279	$ 6,083	$ 196	3.2
Net occupancy expense	956	909	47	5.2
Furniture and equipment expense	429	426	3	0.7
Advertising	734	769	(35)	(4.6)
Legal & professional fees	545	524	21	4.0
Data processing	836	770	66	8.6
Pennsylvania bank shares tax	288	337	(49)	(14.5)
Intangible amortization	234	181	53	29.3
FDIC insurance	914	105	809	770.5
Other	1,900	1,779	121	6.8
Total noninterest expense	$ 13,115	$ 11,883	$ 1,232	10.4

Income taxes

Federal income tax expense was $1.4 million in 2009 and $1.9 million for 2008. The effective tax rate for 2009 was 26.7% and 27.1% for 2008. A decrease in pre-tax income of approximately $1.7 million, due to higher noninterest expense, produced a lower effective tax rate in 2009 compared to 2008. All taxable income for the Corporation is taxed at a rate of 34%.

Financial Condition

At June 30, 2009, assets totaled $966.7 million, an increase of $64.2 million from the 2008 year-end balance of $902.5 million. Deposit growth has been strong since year and has exceeded loan growth. In addition, investment purchase activity has been limited; therefore, federal funds sold and interest -bearing deposits at banks increased by approximately $39.0 million since year-end. The Bank expects these funds to decrease during the third quarter based up projected loan settlements.

The investment portfolio remained flat year over year. The Corporation s investment activity consisted primarily of replacing only those securities needed for collateral. The majority of the investment purchases in 2009 were comprised of U.S. Government Agency notes and mortgage backed securities.

The equity portfolio is comprised of bank stocks and the Bank and the Corporation each maintain separate equity investments. The municipal bond portfolio is well diversified geographically and is comprised primarily of general obligation bonds with credit enhancements in the form of private bond insurance or other credit enhancements. The Bank holds twelve corporate bonds. Seven bonds are single issuer trust preferred bonds. The majority of the mortgage backed security portfolio is comprised of U.S. Government Agency products. However, the Bank has 7 private label Alt-A , mortgage backed securities. Alt-A loans are first-lien residential mortgages that generally conform to traditional prime credit guidelines; however, loan factors such as the loan-to-value ratio, loan documentation, occupancy status or property type cause these loans not to qualify for standard underwriting programs.

The amortized cost and estimated fair value of investment securities available for sale as of June 30, 2009 and December 31, 2008 is:

(Amounts in thousands) **6/30/2009**	**Amortized cost**	**Gross unrealized gains**	**Gross unrealized losses**	**Estimated fair value**
Equity securities	**$ 5,361**	**$ 59**	**$ (1,493)**	**$ 3,927**
U.S. Treasury securities and obligations of U.S. Government agencies	**32,063**	**492**	**(248)**	**32,307**
Obligations of state and political subdivisions	**43,016**	**678**	**(365)**	**43,329**
Corporate debt securities	**11,959**		**(3,425)**	**8,534**
Mortgage-backed securities				
Agency	**52,436**	**1,274**	**(114)**	**53,596**
Non Agency	**6,699**		**(1,112)**	**5,587**
Asset-backed securities	**90**		**(46)**	**44**
	$ 151,624	**$ 2,503**	**$ (6,803)**	**$ 147,324**

12/31/2008	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Equity securities	**$ 5,783**	**$ 18**	**$ (955)**	**$ 4,846**
U.S. Treasury securities and obligations of U.S. Government agencies	**29,548**	**770**	**(287)**	**30,031**
Obligations of state and political subdivisions	**45,518**	**824**	**(659)**	**45,683**
Corporate debt securities	**12,868**		**(3,888)**	**8,980**
Mortgage-backed securities				
Agency	**50,667**	**889**	**(106)**	**51,450**
Non Agency	**7,551**		**(1,033)**	**6,518**
Asset-backed securities	**95**		**(44)**	**51**

$ 152,030	**$ 2,501**	**$ (6,972)**	**$ 147,559**

At June 30, 2009, the investment portfolio contained 129 securities with $63.4 million of temporarily impaired fair value and $6.8 million in unrealized losses. The fair value of temporarily impaired securities is higher than at year-end; however, the unrealized loss and number of securities is lower than at year-end. Financial assets continue to experience pricing pressure as the recession moves throughout all sectors of the economy. For these securities, Management applies a systematic methodology in order to perform an assessment of the potential for other-than-temporary impairment. In the case of debt securities, investments considered for other-than-temporary impairment: (1) had a specified maturity or repricing date; (2) were generally expected to be redeemed at par, and (3) were expected to achieve a recovery in market value within a reasonable period of time. Accordingly, the impairments identified on debt securities and subjected to the assessment at June 30, 2009 were deemed to be temporary and required no further adjustment to the financial statements.

The majority of the unrealized loss is in the corporate debt portfolio ($3.4 million) and has existed for more than one year. Within this sector, $2.8 million of the unrealized loss is in 7 trust preferred securities. However, this unrealized loss represents a slight improvement over the year-end trust preferred unrealized loss. The trust preferred securities held by the Bank are all single entity issues that continue to perform and maintain investment grade credit ratings. However, due to the nature of trust-preferred securities, the long final maturities have compounded the price declines. All of the tust preferred issues are from companies that have received money from the Troubled Asset Relief Program (TARP) established by the Emergency Economic Stabilization Act of 2008 (EESA) in order to boost their capital position. Also included in the corporate sector are two bonds issued by CIT Financial, Inc. The value of these bonds has fallen since June 30, 2009 due to recent news from CIT about its liquidity position. See Note 9 of the accompanying unaudited financial statements for additional information on the CIT bonds.

The largest unrealized loss in the mortgage backed security portfolio is in the non-agency private label Alt-A sector. The Alt-A product is comprised of fixed-rate product that was originated between 2004 and 2006. All of these bonds have some type of credit support tranche that will absorb any loss prior to losses at the senior tranche held by the Bank. The Bank monitors the performance of the Alt-A investments on a regular basis and reviews default rates, credit support levels and various cash flow stress test scenarios. Management believes that these investments do not offer any undue risk of loss.

Equity securities are assessed for other-than-temporary impairment based on the length of time of impairment, dollar amount of the impairment and general market conditions relating to specific issues. Unrealized losses on equity securities continued to increase throughout 2009, despite the recognition of other than temporary impairment charges. In 2008, most of the price depreciation occurred in regional and national bank stocks. In 2009, most the price depreciation has occurred in community bank stocks. Based on Management s review, equity write-downs of $421 thousand were taken in 2009. It is possible that additional write-downs may be required in 2009.

Table of Contents

The following table reflects temporary impairment in the investment portfolio (excluding restricted stock), aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of June 30, 2009 and December 31, 2008:

	June 30, 2008								
	Less than 12 months			**12 months or more**			**Total**		
(Amounts in thousands)	**Fair Value**	**Unrealized Losses**	**Count**	**Fair Value**	**Unrealized Losses**	**Count**	**Fair Value**	**Unrealized Losses**	**Count**
Equity securities	**$ 483**	**$ (281)**	**3**	**$ 2,650**	**$ (1,212)**	**25**	**$ 3,133**	**$ (1,493)**	**28**
U.S. Treasury securities and obligations of U.S. Government agencies	**9,131**	**(24)**	**22**	**12,049**	**(224)**	**20**	**21,180**	**(248)**	**42**
Obligations of State and Political Subdivisions	**11,572**	**(265)**	**24**	**1,307**	**(100)**	**3**	**12,879**	**(365)**	**27**
Corporate debt securities				**8,432**	**(3,425)**	**12**	**8,432**	**(3,425)**	**12**
Mortgage-backed securities									
Agency	**11,899**	**(113)**	**9**	**235**	**(1)**	**1**	**12,134**	**(114)**	**10**
Non Agency				**5,587**	**(1,112)**	**7**	**5,587**	**(1,112)**	**7**
Asset-backed securities				**44**	**(46)**	**3**	**44**	**(46)**	**3**
Total temporarily impaired securities	**$ 33,085**	**$ (683)**	**58**	**$ 30,304**	**$ (6,120)**	**71**	**$ 63,389**	**$ (6,803)**	**129**

	December 31, 2008								
	Less than 12 months			12 months or more			Total		
(Amounts in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
Equity securities	**$ 1,933**	**$ (701)**	**17**	**$ 382**	**$ (254)**	**8**	**$ 2,315**	**$ (955)**	**25**
U.S. Treasury securities and obligations of U.S. Government agencies	**7,018**	**(69)**	**27**	**10,113**	**(218)**	**15**	**17,131**	**(287)**	**42**
Obligations of State and Political Subdivisions	**14,137**	**(659)**	**32**				**14,137**	**(659)**	**32**
Corporate debt securities	**3,722**	**(448)**	**4**	**5,158**	**(3,440)**	**9**	**8,880**	**(3,888)**	**13**
Mortgage-backed securities									
Agency	**6,689**	**(70)**	**9**	**1,257**	**(36)**	**4**	**7,946**	**(106)**	**13**
Non Agency	**6,517**	**(1,033)**	**7**				**6,517**	**(1,033)**	**7**
Asset-backed securities	**16**	**(7)**	**1**	**35**	**(37)**	**2**	**51**	**(44)**	**3**
Total temporarily impaired securities	**$ 40,032**	**$ (2,987)**	**97**	**$ 16,945**	**$ (3,985)**	**38**	**$ 56,977**	**$ (6,972)**	**135**

The Bank held $6.5 million of restricted stock at June 30, 2009. Except for $30 thousand, this investment represents stock in the FHLB, which the Bank is required to hold to be a member of FHLB, and is carried at cost of $100 per share. In December 2008, FHLB announced it would suspend its cash dividend and the repurchase of excess capital stock from its members due to deterioration in its financial condition. At June 30, 2009, the Bank held approximately

$1.1 million in excess FHLB stock that it would not have been required to hold prior to the suspension of the stock repurchase program. FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support it operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment.

Table of Contents

Net loans have increased $26.6 million since year-end. Commercial lending activity continues to be good and these balances have increased more than $41.5 million since year-end. The majority of the new commercial loans are variable rate and are secured by real estate. These loans are a mix of in-market production and purchased loans in south central Pennsylvania. However, the growth in commercial loans was partially offset by a decrease of approximately $6.4 million in the residential mortgage loan portfolio and $7.9 million in the consumer portfolio. The mortgage portfolio is expected to continue to run-off as the Bank is originating mortgages, but is not funding, servicing or retaining the loans. The decrease in the consumer loan portfolio is primarily from pay downs on home equity loans, much of which was a result of refinancing a first mortgage.

The following table presents a summary of loans outstanding at:

(Amounts in thousands)	**June 30, 2009**	December 31, 2008	Change Amount	Change %
Residential mortgage loans	**$ 71,515**	$ 78,061	($6,546)	(8.4)
Residential construction loans	**547**	408	139	34.1
Commercial construction and land development	**103,762**	99,027	4,735	4.8
Commercial, industrial and agricultural	**403,000**	366,261	36,739	10.0
Consumer home equity loans and lines of credit	**97,785**	103,523	(5,738)	(5.5)
Consumer other	**26,809**	28,937	(2,128)	(7.4)
	703,418	676,217	27,201	4.0
Less: Allowance for loan losses	**(7,930)**	(7,357)	(573)	7.8
Net Loans	**$ 695,488**	$ 668,860	$ 26,628	4.0
Included in the loan balances are the following:				
Net unamortized deferred loan costs	**$ 632**	$ 646		
Unamortized discount on purchased loans	**$ (336)**	$ (295)		

Total nonperforming assets (including nonperforming loans and foreclosed real estate) as a percent of total assets increased from .44% at December 31, 2008 to 1.26% at June 30, 2009. Nonperforming loans drove the increase in nonperforming assets as evidenced by the increase in nonperforming loans as a percent of total gross loans, from .59% at December 31, 2008 to 1.67% at June 30, 2009.

Nonperforming loans (i.e., 90-days or more past due and still accruing interest [Ninety-Day] and nonaccrual loans) were primarily comprised of residential mortgage and commercial loans.

Ninety-Day residential mortgages increased by approximately $1.0 million while nonaccruing residential mortgages decreased marginally due to a June 2009 foreclosure. Despite this increase in delinquency, Management estimates no risk of loss associated with these loans.

Ninety-Day commercial loans increased by $3.1 million and nonaccruing commercial loans increased by $3.7 million. Two significant construction and land development (ACD) credits and one significant agricultural credit drove the increases in both categories. Management has identified and specifically allocated for the associated risk of loss not mitigated with additional collateral.

On June 30, 2009, the Corporation settled with PNC, N.A. the litigation of claims relating to loans purchased from its subsidiary Equipment Finance LLC, the terms of which are subject to a confidentiality agreement. The total loss on the original $7.5 million portfolio was $245.8 thousand.

The nonperforming loan increase caused the coverage of nonperforming loans by the allowance for loan loss (ALL) to decrease from 183.93% to 67.62%. The Corporation held one foreclosed property for $413 thousand at June 30, 2009 compared to $0 at December 31, 2008.

The following table presents a summary of nonperforming assets:

(Dollars in thousands)	**June 30, 2009**	December 31, 2008
Nonaccrual loans		
Consumer	**$**	$
Residential mortgage	**164**	333
Construction and land development	**4,091**	1,286
Farm real estate	**2,052**	
Commercial	**49**	1,252
Total nonaccrual loans	**$ 6,356**	$ 2,871
Loans past due 90 days or more and not included above		
Consumer	**$ 209**	$ 123
Residential mortgage	**1,570**	544
Construction and land development	**2,585**	429
Farm real estate	**400**	
Commercial	**607**	33
Total loans past due 90 days or more and still accruing	**$ 5,371**	$ 1,129
Total nonperforming loans	**11,727**	4,000
Foreclosed real estate	**413**	
Total nonperforming assets	**$ 12,140**	$ 4,000
Nonperforming loans to total gross loans	**1.67%**	0.59%
Nonperforming assets to total assets	**1.26%**	0.44%
Allowance for loan losses to nonperforming loans	**67.62%**	183.93%

Net charge-offs increased during the first half of 2009 to $446 thousand compared to $363 thousand in the first half of 2008. Consumer loans accounted for the largest gross charge-off category during the first half of 2009. The annualized net charge-off ratio was .13% at June 30, 2009, comparing unfavorably to the .06% annualized net charge-off ratio at June 30, 2008 and favorably to the actual .19% net charge-off ratio at December 31, 2008.

The provision for loan loss expense was $1.0 million for the first half of 2009, compared to $505 thousand for the first half of 2008. Management recognized an additional $432 thousand provision expense based on the increased loan losses and specific reserves for nonperforming loans. The ALL as a percentage of loans increased slightly from 1.09% at year-end 2008 to 1.13% at June 30, 2009.

Table of Contents

The following table presents an analysis of the allowance for loan losses.

(Dollars in thousands)	Six Months Ended June 30 **2009**	2008	Twelve Months Ended 12/31/2008
Balance at beginning of year	**$ 7,357**	$ 7,361	$ 7,361
Charge-offs:			
Commercial, industrial and agricultural	**(200)**	(204)	(713)
Consumer	**(322)**	(254)	(496)
Real estate	**(94)**		(224)
Total charge-offs	**(616)**	(458)	(1,433)
Recoveries:			
Commercial, industrial and agricultural	**58**	5	47
Consumer	**97**	80	165
Real estate	**15**	10	24
Total recoveries	**170**	95	236
Net charge-offs	**(446)**	(363)	(1,197)
Provision for loan losses	**1,019**	505	1,193
Balance at end of year	**$ 7,930**	$ 7,503	$ 7,357
Ratios:			
Annualized net loans charged-off as a percentage of average loans	**0.13%**	**0.06%**	0.19%
Net loans charged-off as a percentage of the provision for loan losses	**43.77%**	**71.88%**	100.34%
Allowance as a percentage of loans	**1.13%**	**1.22%**	1.09%

Management monitors the adequacy of the allowance for loan losses on an ongoing basis and reports its adequacy assessment monthly to the Board of Directors. Management believes that the allowance for loan losses is adequate.

Other intangible assets are comprised of a core deposit intangible and a customer list and are being amortized over the estimated useful life of the asset.

Total deposits increased $82.7 million during the first half of 2009 to $710.0 million from year-end 2008. Non-interest bearing deposits decreased $6.9 million, but were more than offset by an increase in interest-bearing deposits. Savings and interest-bearing checking deposits increased $23.9 million and time deposits increased $65.6 million. Retail time deposits increased since year-end due to a CD promotion and the acquisition of some large dollar municipal accounts. The Bank also took out brokered deposits in the amount of $16.9 million in the first six months of 2009, much of it at rates below local market rates. In 2008, the Bank became a member of the Promontory Network and began offering CDs through CDARS. CDARS places large deposits into CDs with other network member banks in increments less than the FDIC insurance maximum, thereby providing insurance coverage on the entire balance. As of June 30, 2009, the Bank had $22.8 million in CDARS deposits included in brokered time deposits. The Bank s Money Management product increased $8.5 million due in part to a promotion in selected markets and higher consumer savings levels.

The following table presents a summary of deposits outstanding at:

(Amounts in thousands)		**June 30, 2009**		December 31, 2008		Change Amount	%
Demand, noninterest-bearing	**$**	**80,081**	$	86,954		($6,873)	(7.9)
Interest-bearing checking		**97,104**		86,241		10,863	12.6
Savings:							
Money market accounts		**211,643**		203,171		8,472	4.2
Passbook and statement savings		**50,565**		46,006		4,559	9.9
Total savings and interest checking		**359,312**		335,418		23,894	7.1
Time:							
Deposits of $100,000 and over		**56,973**		50,510		6,463	12.8
Brokered time deposits		**46,185**		16,504		29,681	179.8
Other time deposits		**167,442**		137,955		29,487	21.4
		270,600		204,969		65,631	32.0
Total deposits	**$**	**709,993**	$	627,341	$	82,652	13.2
Overdrawn deposit accounts reclassified as loan balances	**$**	**210**	$	181			

The Repo balance has increased $704 thousand from year-end, while long-term debt from the FHLB decreased $2.7 million due to scheduled pay downs and the prepayment of $1.3 million high-rate term loan in the second quarter.

Total shareholders equity increased $2.9 million to $76.0 million at June 30, 2009, compared to $73.1 million at the end of 2008. The increase in retained earnings from the Corporation s net income of $3.7 million was partially offset by the cash dividend of $2.1 million. The increase of $929 thousand in accumulated other comprehensive loss is the result of a slight improvement in the market value of investment securities available for sale. The Corporation s dividend payout ratio of 55% for the first six months exceeds the 2008 year-end ratio of 48%. The payout ratio is higher than normal due to lower second quarter earnings that were affected by higher provision expense, other than temporary impairment charges and the FDIC special assessment. As capital levels become increasingly important during this difficult economic period, the Corporation decided not to increase its second quarter dividend, as has been its past practice. Management views the dividend payout as a critical piece of its capital management plan. Additionally, the Corporation is currently exploring other sources of capital as part of its capital management plan for the Corporation and the Bank. The Corporation repurchased 5,640 shares of the Corporation s common stock for $93 thousand during the first six months of 2009.

Table of Contents

Capital adequacy is currently defined by regulatory agencies through the use of several minimum required ratios. At June 30, 2009, the Corporation was well capitalized as defined by the banking regulatory agencies. Regulatory capital ratios for the Corporation and the Bank are shown below:

			Regulatory Ratios	
				Well Capitalized
	June 30, 2009	**December 31, 2008**	**Minimum**	**Minimum**
Total Risk Based Capital Ratio (1)				
Franklin Financial Services Corporation	**10.84%**	11.02%	8.00%	n/a
Farmers & Merchants Trust Company	**10.41%**	10.29%	8.00%	10.00%
Tier 1 Capital Ratio (2)				
Franklin Financial Services Corporation	**9.74%**	9.96%	4.00%	n/a
Farmers & Merchants Trust Company	**9.31%**	9.21%	4.00%	6.00%
Leverage Ratio (3)				
Franklin Financial Services Corporation	**7.57%**	7.84%	4.00%	n/a
Farmers & Merchants Trust Company	**7.22%**	7.26%	4.00%	5.00%

(1) Total risk-based capital / total risk-weighted assets, (2)Tier 1 capital / total risk-weighted assets, (3) Tier 1 capital / average quarterly assets

Economy

The Corporation operates in Franklin, Cumberland, Fulton and Huntingdon Counties, Pennsylvania. The general economic conditions in this market have deteriorated since year-end and unemployment rates are vastly different from county to county. Franklin County s unemployment rate was 8.3%, Cumberland County s rate was 6.6% and Fulton County s rate was 13.41% at June 30, 2009. Two large global manufacturers have laid-off workers due to a slow down in production and this has contributed to the increase in unemployment rates. These rates compare to the Pennsylvania state average of 8.2%. Management believes that the Bank s primary market area continues to be well suited for growth when the national recession eases. The Corporation is not overly dependent on any one industry within its market area and the industries located in its market area are well diversified. Housing prices have declined and housing sales have slowed; however, the Corporation s market area has not been affected by increased home foreclosures as much as other areas of the country have.

Unlike many companies, the assets and liabilities of the Corporation are financial in nature. As such, interest rates and changes in interest rates may have a more significant effect on the Corporation s financial results than on other types of industries. Because of this, the Corporation watches the actions of the Federal Reserve Open Market Committee (FOMC) as it makes decisions about interest rate changes. The Fed continued to decrease rates through 2008. The fed funds target rate was decreased by 4% in 2008 from 4.25% to .25% at year-end and has remained unchanged in 2009. The effort by the Federal Reserve to reduce short-term rates has had a negative effect on the Corporation s net interest margin. If rates continue to remain low, it is unlikely that the net interest margin will improve in 2009.

Liquidity

The Corporation must meet the financial needs of the customers that it serves, while providing a satisfactory return on the shareholders investment. In order to accomplish this, the Corporation must maintain sufficient liquidity in order to respond quickly to the changing level of funds required for both loan and deposit activity. The goal of liquidity management is to meet the ongoing cash flow requirements of depositors who want to withdraw funds and of borrowers who request loan disbursements. The Bank regularly reviews it liquidity position by measuring its projected net cash flows (in and out) at a 30 and 90-day interval. The Bank stresses this measurement by assuming a level of deposit out-flows that have not historically been realized. In addition to this forecast, other funding sources are reviewed as a method to provide emergency funding if necessary. The objective of this measurement is to identify the amount of cash that could be raised quickly without the need to liquidate assets. The Bank believes it can meet all anticipated liquidity demands.

Table of Contents

Historically, the Corporation has satisfied its liquidity needs from earnings, repayment of loans and amortizing investment securities, maturing investment securities, loan` sales, deposit growth and its ability to access existing lines of credit. All investments are classified as available for sale; therefore, securities that are not pledged as collateral for borrowings are an additional source of readily available liquidity, either by selling the security or, more preferably, to provide collateral for additional borrowing. At June 30, 2009, the Bank had approximately $140 million of its investment portfolio pledged as collateral. Another source of liquidity for the Bank is a line of credit with the FHLB. The FHLB system has always been a major source of funding for community banks. The capital level of the FHLB, and the entire FHLB system, has been strained due to the declining value of mortgage related assets. The FHLB has implemented steps to improve its capital position that included a suspension of its dividend and an end to its practice of redeeming members stock. Both of these actions are not favorable to the Bank. There are no indicators that lead the Bank to believe the FHLB will discontinue its lending function. If that were to occur, it would have a negative effect on the Bank and it is unlikely that the Bank could replace the level of FHLB funding in a short time. Another action that may be considered by FHLB to increase its capital is to have a capital call on its member banks. This would require the member banks to invest more capital into the FHLB when most banks would prefer not make such an investment. At June 30, 2009, the Bank had approximately $114 million available on this line of credit.

In addition, the Bank has $16 million in lines of credit at two correspondent banks and approximately $49 million in funding available at the Federal Reserve Discount Window. The Bank is continuing to increase its funding level at the discount window. The Bank also has the ability to access other funding sources including wholesale borrowings and brokered CDs.

Off Balance Sheet Commitments and Contractual Obligations

The Corporation s financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist mainly of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Corporation. Unused commitments and standby letters of credit totaled $197.9 million and $183.1 million, respectively, at June 30, 2009 and December 31, 2008.

The Corporation has entered into various contractual obligations to make future payments. These obligations include time deposits, long-term debt, operating leases, deferred compensation and pension payments. These amounts have not changed materially from those reported in the Corporation s 2008 Annual Report on Form 10-K.

Table of Contents

PART I, Item 3

Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in the Corporation s exposure to market risk during the three months ended June 30, 2009. For more information on market risk refer to the Corporation s 2008 Annual Report on Form 10-K.

PART I, Item 4

Controls and Procedures

Evaluation of Controls and Procedures

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation s management, including the Corporation s Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation s Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2009, the Corporation s disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in the Corporation s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in Internal Controls

Management assessed the effectiveness of the Corporation s internal control over financial reporting as of June 30, 2009, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework. Based on this assessment, management concluded that, as of June 30, 2009, the Corporation s internal control over financial reporting is effective based on those criteria.

There were no changes during the three months ended June 30, 2009 in the Corporation s internal control over financial reporting which materially affected, or which are reasonably likely to affect, the Corporation s internal control over financial reporting.

Table of Contents

Part II OTHER INFORMATION

Item 1. Legal Proceedings

The nature of the Corporation s business generates a certain amount of litigation involving matters arising in the ordinary course of business. However, in management s opinion, there are no proceedings pending to which the Corporation is a party or to which our property is subject, which, if determined adversely to the Corporation, would be material in relation to our shareholders equity or financial condition. In addition, no material proceedings are pending or are known to be threatened or contemplated against us by governmental authorities or other parties.

Item 1A. Risk Factors

There were no material changes in the Corporation s risk factors during the three months ended June 30, 2009. For more information, refer to the Corporation s 2008 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Corporation announced a stock repurchase plan on July 10, 2008 to repurchase up to 100,000 shares of the Corporation s common stock over a 12 month time period. As of June 30, 2009, 21,972 shares have been purchased under this plan. The following chart reports stock repurchases made during the second quarter of 2009:

Period	Number of Shares Purchased	Weighted Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Number of Shares that May Yet Be Purchased Under Program
April 2009				83,668
May 2009				83,668
June 2009	2,640	$ 16.00	2,640	81,028
Total	2,640	$ 16.00	2,640	

On July 9, 2009, the Corporation announced a stock repurchase plan to repurchase up to 100,000 shares of the Corporation s common stock over a twelve month time period.

Item 3. Defaults by the Company on its Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

The 2009 Annual Meeting of Shareholders (the Meeting) of the Corporation was held on April 28, 2009. The Meeting was held for the following purpose:

1. Election of Directors. To elect three Class C Directors to hold office for 3 years from the date of election and until their successors are elected and qualified.

Table of Contents

There was no solicitation in opposition to the nominees of the Board of Directors for election to the Board. All nominees of the Board of Directors were elected. The number of votes cast, as well as the number of votes withheld for each of the nominees for election to the Board of Directors, was as follows:

Nominee	Votes For	Votes Withheld
Donald A. Fry	3,001,897	80,104
Charles M. Sioberg	3,014,957	67,044
Kurt E. Suter	2,959,213	122,788

The following Directors continued their term of office after the meeting:

Charles S. Bender, II, Martin R. Brown, G. Warren Elliott, Allan E. Jennings Jr., Stanley J. Kerlin, Jeryl C. Miller, Stephen E. Patterson, William E. Snell, Jr. and Martha B. Walker.

2. Vote on shareholder proposal requesting declassification of the Board of Directors. The proposal was defeated.

Votes Against	Votes Abstained	Votes For	Nonvoted Shares
2,238,408	38,859	245,121	559,613

Item 5. Other Information

None

Item 6. Exhibits

Exhibits

31.1	Rule 13a 14(a)/15d-14(a) Certifications	Chief Executive Officer
31.2	Rule 13a 14(a)/15d-14(a) Certifications	Chief Financial Officer
32.1	Section 1350 Certifications	Chief Executive Officer
32.2	Section 1350 Certifications	Chief Financial Officer

Table of Contents

FRANKLIN FINANCIAL SERVICES CORPORATION
and SUBSIDIARIES

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.

	Franklin Financial Services Corporation
August 10, 2009	/s/ William E. Snell, Jr.
	William E. Snell, Jr. President and Chief Executive Officer
August 10, 2009	/s/ Mark R. Hollar
	Mark R. Hollar Treasurer and Chief Financial Officer

40

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
31.1	Rule 13a 14(a)/15d-14(a) Certifications Chief Executive Officer
31.2	Rule 13a 14(a)/15d-14(a) Certifications Chief Financial Officer
32.1	Section 1350 Certifications Chief Executive Officer
32.2	Section 1350 Certifications Chief Financial Officer