

MID PENN BANCORP INC  
Form 10-K  
March 05, 2009  
[Table of Contents](#)

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

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2008

**OR**

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

For the transition period from            to

Commission file number 1-13677

**MID PENN BANCORP, INC.**

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

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

<b>Pennsylvania</b> <i>(State or Other Jurisdiction of</i>	<b>25-1666413</b> <i>(I.R.S. Employer</i>
<i>Incorporation or Organization)</i>	<i>Identification Number)</i>
<b>349 Union Street</b>	
<b>Millersburg, Pennsylvania</b> <i>(Address of Principal Executive Offices)</i>	<b>17061</b> <i>(Zip Code)</i>
<b>Registrant's telephone number, including area code 717.692.2133</b>	

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

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
<b>Common Stock, \$1.00</b>	<b>The NASDAQ Stock Market, Inc.</b>
<b>Securities registered pursuant to Section 12(g) of the Act: None.</b>	

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

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

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

Large accelerated filer ☐ Accelerated Filer ☒ Non-accelerated Filer ☐ Smaller Reporting Company ☐

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates computed by reference to the closing price of the common equity of \$25.20 per share, as reported by NASDAQ, on June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter was approximately \$87,690,456.

As of February 1, 2009, the registrant had 3,479,780 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement to be used in connection with the 2009 Annual Meeting of Shareholders is incorporated herein by reference in partial response to Part III, hereof.

**Table of Contents**

**MID PENN BANCORP, INC.**

**FORM 10-K**

**TABLE OF CONTENTS**

	<b>PAGE</b>
<b><u>PART I</u></b>	
Item 1 - <u>Business</u>	1
Item 1A - <u>Risk Factors</u>	9
Item 1B - <u>Unresolved Staff Comments</u>	12
Item 2 - <u>Properties</u>	12
Item 3 - <u>Legal Proceedings</u>	13
Item 4 - <u>Submission of Matters to a Vote of Security Holders</u>	13
<b><u>PART II</u></b>	
Item 5 - <u>Market for Registrant's Common Equity, Related Stockholder Matters And Issuer Purchases of Equity Securities</u>	14
Item 6 - <u>Selected Financial Data</u>	16
Item 7 - <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 7A - <u>Quantitative and Qualitative Disclosure About Market Risk</u>	31
Item 8 - <u>Financial Statements and Supplementary Data</u>	32
Item 9 - <u>Changes In and Disagreements With Accountants on Accounting and Financial Disclosure</u>	64
Item 9A - <u>Controls and Procedures</u>	64
Item 9B - <u>Other Information</u>	65
<b><u>PART III</u></b>	
Item 10 - <u>Directors, Executive Officers and Corporate Governance</u>	66
Item 11 - <u>Executive Compensation</u>	66
Item 12 - <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	66
Item 13 - <u>Certain Relationships and Related Transactions, and Director Independence</u>	66
Item 14 - <u>Principal Accountant Fees and Services</u>	66
<b><u>PART IV</u></b>	
Item 15 - <u>Exhibits and Financial Statement Schedules</u>	66
<u>Signatures</u>	68
<b><u>EXHIBIT INDEX</u></b>	69

---

**Table of Contents**

**MID PENN BANCORP, INC.**

**PART I**

**ITEM 1. BUSINESS**

The disclosures set forth in this Item are qualified by the section captioned "Special Cautionary Notice Regarding Forward-Looking Statements" contained in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report.

**Mid Penn Bancorp, Inc.**

Mid Penn Bancorp, Inc. is a one-bank holding company, incorporated in the Commonwealth of Pennsylvania in August 1991. On December 31, 1991, MPB acquired, as part of the holding company formation, all of the outstanding common stock of Mid Penn Bank, and the Bank became a wholly owned subsidiary of MPB. MPB's other wholly owned subsidiaries are Mid Penn Insurance Services, LLC, which provides a range of personal and investment insurance products and Mid Penn Investment Corporation, which is engaged in investing activities. Mid Penn Bancorp, Inc. and its wholly owned subsidiaries are collectively referred to herein as "MPB" or the "Company." MPB's primary business is to supervise and coordinate the business of its subsidiaries and to provide them with capital and resources.

MPB's consolidated financial condition and results of operations consist almost entirely of that of Mid Penn Bank, which is managed as a single business segment. At December 31, 2008, MPB had total consolidated assets of \$572,300,000 total deposits of \$436,824,000 and total shareholders' equity of \$50,890,000.

As of December 31, 2008, Mid Penn Bancorp, Inc. did not own or lease any properties. Mid Penn Bank owns the banking offices as identified in Item 2. All MPB employees are employed by Mid Penn Bank, Mid Penn Insurance Services, LLC or Mid Penn Investment Corporation.

**Mid Penn Bank**

Millersburg Bank, the predecessor to Mid Penn Bank (the "Bank"), was organized in 1868, and became a state chartered bank in 1931, obtaining trust powers in 1935, at which time its name was changed to Millersburg Trust Company. In 1962, the Lykens Valley Bank merged with and into Millersburg Trust Company. In 1971, Farmer's State Bank of Dalmatia merged with Millersburg Trust Company and the resulting entity adopted the name "Mid Penn Bank." In 1985, the Bank acquired Tower City National Bank. In 1998, MPB acquired Miners Bank of Lykens, which was merged into Mid Penn Bank. The Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation supervise the Bank. MPB's and the Bank's legal headquarters are located at 349 Union Street, Millersburg, Pennsylvania 17061. The Bank presently has 14 offices located in Dauphin, Northumberland, Schuylkill, and Cumberland Counties, Pennsylvania.

MPB's primary business consists of attracting deposits from its network of community banking offices operated by the Bank. The Bank engages in full-service commercial banking and trust business, making available to the community a wide range of financial services, including, but not limited to, installment loans, personal loans, mortgage and home equity loans, secured and unsecured commercial and consumer loans, lines of credit, construction financing, farm loans, community development and local government loans and various types of time and demand deposits. Deposits of the Bank are insured by the Bank Insurance Fund of the FDIC to the maximum extent provided by law. In addition, the Bank provides a full range of trust services through its Trust Department. The Bank also offers other services such as Internet banking, telephone banking, cash management services, automated teller services and safe deposit boxes.

*Business Strategy*

The Bank provides an array of sophisticated products typically found only in major regional banks. These services are provided to small to middle market businesses, high net worth individuals, and retail consumers through 14 full service banking facilities. Several banking locations have seasoned management with significant lending experience who are responsible for credit and pricing decisions, subject to loan committee approval for larger credits. This decentralized relationship management approach, coupled with the continuity of service by its banking officers, enables the Bank to develop long-term customer relationships, maintain high quality service and provide quick responses to customer needs. MPB believes that its emphasis on local relationship banking, together with its conservative approach to lending and resultant strong asset quality, are important factors in the success and the growth of MPB.

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

The Bank seeks credit opportunities of good quality within its target market that exhibit positive historical trends, stable cash flows and secondary sources of repayment from tangible collateral. The Bank extends credit for the purpose of obtaining and continuing long-term relationships. Lenders are provided with detailed underwriting policies for all types of credit risks accepted by the Bank and must obtain appropriate approvals for credit extensions in excess of conservatively assigned individual lending limits. The Bank also maintains strict documentation requirements and extensive credit quality assurance practices in order to identify credit portfolio weaknesses as early as possible so any exposures that are discovered might be reduced.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

At December 31, 2008, the Bank had 142 full-time and 33 part-time employees. The Bank and its employees are not subject to a collective bargaining agreement, and the Bank believes it enjoys good relations with its personnel.

### **Lending Activities**

The Bank offers a variety of loan products to its customers, including loans secured by real estate, commercial and consumer loans. The Bank's lending objectives are as follows:

to establish a diversified commercial loan portfolio; and

to provide a satisfactory return to MPB's shareholders by properly pricing loans to include the cost of funds, administrative costs, bad debts, local economic conditions, competition, customer relationships, the term of the loan, credit risk, collateral quality and a reasonable profit margin.

Credit risk is managed through portfolio diversification, underwriting policies and procedures and loan monitoring practices. The Bank generally secures its loans with real estate with such collateral values dependent and subject to change based on real estate market conditions within its market area. As of December 31, 2008, the Bank's highest concentrations of credit were in hotel/motel and multiple-family housing financings and most of the Bank's business activity with customers was located in Central Pennsylvania, specifically in Dauphin, lower Northumberland, Western Schuylkill, and Cumberland Counties.

### **Investment Activities**

MPB's investment portfolio is used to improve earnings through investments of funds in higher-yielding assets, while maintaining asset quality, which provide the necessary balance sheet liquidity for MPB. MPB does not have any significant concentrations within investment securities.

MPB's entire portfolio of investment securities is considered available for sale. As such, the investments are recorded on the balance sheet at market value. MPB's investments include US Treasury, agency and municipal securities that are given a market price relative to investments of the same type with similar maturity dates. As the interest rate environment changes, MPB's market value of existing securities will change. This difference in value, or unrealized gain, amounted to \$838,000, as of December 31, 2008. A majority of the investments are high quality United States and municipal securities that if held to maturity are expected to yield no loss to the Bank.

For additional information with respect to MPB's business activities, see Part II, Item 7 of this report, which is incorporated herein by reference.

### **Sources of Funds**

The Bank primarily uses deposits and borrowings to finance lending and investment activities. Borrowing sources include advances from the Federal Home Loan Bank of Pittsburgh, reverse repurchase agreements with investment banks and overnight borrowings from the Bank's customers and correspondent bank. All borrowings, except for the line of credit with the Bank's correspondent bank, require collateral in the form of loans or securities. Collateral levels therefore, limit borrowings and the available lines of credit extended by the Bank's creditors. As a result, deposits remain key to the future funding and growth of the business. Deposit growth within the banking industry has been generally slow due to strong competition from a variety of financial services companies. This competition may require financial institutions to adjust their product offerings and pricing to adequately grow deposits.

### **Competition**

The banking business is highly competitive, and the profitability of MPB depends principally upon the Bank's ability to compete in its market area. The Bank actively competes with other financial services companies for deposit and loan business. Competitors include other commercial banks, savings banks, savings and loan associations, insurance companies, securities brokerage firms, credit unions, finance companies, mutual funds, and money market funds. Financial institutions compete primarily on the quality of services rendered, interest rates on loans and deposits,

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

service charges, the convenience of banking facilities, location and hours of operation and, in the case of loans to larger commercial borrowers, relative lending limits.

Many competitors are significantly larger than the Bank and have significantly greater financial resources, personnel and locations from which to conduct business. In addition, the Bank is subject to banking regulations while certain competitors may not be. There are relatively few barriers for companies wanting to enter into the financial services industry. For more information, see the [Supervision and Regulation](#) section below.

MPB has been able to compete effectively with other financial institutions by emphasizing technology and customer service, including local branch decision making on loans, establishing long-term customer relationships and building customer loyalty, and providing products and services designed to address the specific needs of its customers. The Gramm-Leach-Bliley Act (see discussion below), which breaks down many barriers between the banking, securities and insurance industries, may significantly affect the competitive environment in which MPB operates.



## **Table of Contents**

### **MID PENN BANCORP, INC.**

The growth of mutual funds over the past decade has made it increasingly difficult for financial institutions to attract deposits. The continued flow of cash into mutual funds, much of which is made through tax deferred investment vehicles such as 401(k) plans, and a generally strong economy, have, until recently, fueled high returns for these investments, in particular, certain equity funds. These returns perpetuated the flow of additional investment dollars into mutual funds and other products not traditionally offered by banks.

MPB's success is dependent to a significant degree on economic conditions in Central Pennsylvania, especially in Dauphin, lower Northumberland, Western Schuylkill and eastern Cumberland Counties, which we define as our primary market. The banking industry is affected by general economic conditions including the effects of inflation, recession, unemployment, real estate values, trends in the national and global economics, and other factors beyond our control. An economic recession or a delayed recovery over a prolonged period of time in the Central Pennsylvania area could cause an increase in the level of the Bank's non-performing assets and loan and lease losses, thereby causing operating losses, impairing liquidity and eroding capital. We cannot assure you that adverse changes in the local economy would not have a material adverse effect on MPB's consolidated financial condition, results of operations, and cash flows.

### **Supervision and Regulation**

#### *General*

Bank holding companies and banks are extensively regulated under both Federal and state laws. The regulation and supervision of MPB and the Bank are designed primarily for the protection of depositors, the FDIC, and the monetary system, and not MPB or its shareholders. Enforcement actions may include the imposition of a conservator or receiver, cease-and-desist orders and written agreements, the termination of insurance on deposits, the imposition of civil money penalties and removal and prohibition orders. If a banking regulator takes any enforcement action, the value of an equity investment in MPB could be substantially reduced or eliminated.

Federal and state banking laws contain numerous provisions affecting various aspects of the business and operations of MPB and the Bank. MPB is subject to, among others, the regulations of the Securities and Exchange Commission and the Federal Reserve Board and the Bank is subject to, among others, the regulations of the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation. The following descriptions of and references to applicable statutes and regulations are not intended to be complete descriptions of these provisions or their effects on MPB or the Bank. They are summaries only and are qualified in their entirety by reference to such statutes and regulations.

#### *Holding Company Regulation*

MPB is a registered bank holding company subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve). As such, it is subject to the Bank Holding Company Act of 1956 (BHCA) and many of the Federal Reserve's regulations promulgated thereunder. The Federal Reserve has broad enforcement powers over bank holding companies, including the power to impose substantial fines and civil penalties.

The BHCA requires MPB to file an annual report with the Federal Reserve regarding the holding company and its subsidiary bank. The Federal Reserve Board also makes examinations of the holding company. The Bank is not a member of the Federal Reserve System; however, the Federal Reserve possesses cease-and-desist powers over bank holding companies and their subsidiaries where their actions would constitute an unsafe or unsound practice or violation of law.

The BHCA restricts a bank holding company's ability to acquire control of additional banks. In addition, the BHCA restricts the activities in which bank holding companies may engage directly or through non-bank subsidiaries.

#### *Gramm-Leach-Bliley Financial Modernization Act*

The Gramm-Leach-Bliley Act (GLB) became effective on March 11, 2000. The primary purpose of GLB was to eliminate barriers between investment banking and commercial banking and to permit, within certain limitations, the affiliation of financial service providers. Generally, GLB:

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

repealed the historical restrictions against, and eliminated many federal and state law barriers to affiliations among banks, securities firms, insurance companies and other financial service providers;

provided a uniform framework for the activities of banks, savings institutions and their holding companies;

broadened the activities that may be conducted by and through national banks and other banking subsidiaries of bank holding companies;

## **Table of Contents**

### **MID PENN BANCORP, INC.**

provided an enhanced framework for protecting the privacy of consumers' information;

adopted a number of provisions related to the capitalization, membership, corporate governance and other measures designed to modernize the Federal Home Loan Bank System;

modified the laws governing the implementation of the Community Reinvestment Act; and

addressed a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

More specifically, under GLB, bank holding companies, such as MPB, that meet certain management, capital, and Community Reinvestment Act standards, are permitted to become financial holding companies and, by doing so, to affiliate with securities firms and insurance companies and to engage in other activities that are financial in nature, incidental to such financial activities, or complementary to such activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized under the FDIC Improvement Acts prompt corrective action provisions, is well managed and has at least a satisfactory rating under the Community Reinvestment Act. The required filing is a declaration that the bank holding company wishes to become a financial holding company and meets all applicable requirements.

No prior regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities permitted under GLB. Activities cited by GLB as being financial in nature include:

securities underwriting, dealing and market making;

sponsoring mutual funds and investment companies;

insurance underwriting and agency;

merchant banking activities; and

activities that the Federal Reserve has determined to be closely related to banking.

In addition to permitting financial services providers to enter into new lines of business, the law allows firms the freedom to streamline existing operations and to potentially reduce costs. The Act may increase both opportunity as well as competition. Many community banks are less able to devote the capital and management resources needed to facilitate broad expansion of financial services including insurance and brokerage services.

### *Corporate Governance*

On July 30, 2002, the Sarbanes-Oxley Act of 2002 was enacted. The Sarbanes-Oxley Act represents a comprehensive revision of laws affecting corporate governance, auditor independence and accounting standards, executive compensation, insider loans, whistleblower protection, and enhanced and timely disclosure of corporate information. The Sarbanes-Oxley Act is applicable to all companies with equity securities registered or that file reports under the Securities Exchange Act of 1934. In particular, the Sarbanes-Oxley Act established:

new requirements for audit committees, including independence, expertise and responsibilities;

additional responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company;

new standards for auditors and regulation of audits;

increased disclosure and reporting obligations for the reporting company and its directors and executive officers; and

new and increased civil and criminal penalties for violations of the securities laws.

The SEC and NASDAQ have adopted numerous rules implementing the provisions of the Sarbanes-Oxley Act that affect MPB. The changes are intended to allow shareholders to monitor more effectively the performance of companies and management. Increased costs have been approximately \$200,000 annually related to MPB's compliance with the Sarbanes-Oxley Act.

#### *Bank Regulation*

The Bank, a Pennsylvania-chartered institution, is subject to supervision, regulation and examination by the Pennsylvania Department of Banking and the FDIC. The deposits of the Bank are insured by the FDIC to the extent provided by law. The FDIC assesses deposit insurance premiums the amount of which may, in the future, depend in part on the condition of the Bank. Moreover, the FDIC may terminate deposit insurance of the Bank under certain circumstances. The Bank regulatory agencies have broad enforcement powers over depository institutions under their jurisdiction, including the power to terminate deposit insurance, to impose fines and other civil and criminal penalties, and to appoint a conservator or receiver if any of a number of conditions is met. In addition, the Bank is subject to a variety of local, state and federal laws that affect its operations.

Banking regulations include, but are not limited to, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and the safety and soundness of banking practices.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

#### *Capital Requirements*

Under risk-based capital requirements for bank holding companies, MPB is required to maintain a minimum ratio of total capital to risk-weighted assets (including certain off-balance-sheet activities, such as standby letters of credit) of eight percent. At least half of the total capital is to be composed of common equity, retained earnings and qualifying perpetual preferred stock, less goodwill ( Tier 1 Capital and together with Tier 2 Capital, Total Capital ). The remainder may consist of subordinated debt, non-qualifying preferred stock and a limited amount of the loan loss allowance ( Tier 2 Capital ).

In addition, the Federal Reserve Board has established minimum leverage ratio requirements for bank holding companies. These requirements provide for a minimum leverage ratio of Tier 1 Capital to adjusted average quarterly assets ( leverage ratio ) equal to 3% for bank holding companies that meet certain specified criteria, including having the highest regulatory rating. All other bank holding companies will generally be required to maintain a leverage ratio of from at least 4-5%. The requirements also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the requirements indicate that the Federal Reserve Board will continue to consider a Tangible Tier 1 Leverage Ratio (deducting all intangibles) in evaluating proposals for expansion or new activity. The Federal Reserve Board has not advised MPB of any specific minimum Tier 1 leverage ratio applicable to it.

The Bank is subject to similar capital requirements adopted by the FDIC. The FDIC has not advised the Bank of any specific minimum leverage ratios applicable to it.

The capital ratios of MPB and the Bank are described in Note 17 to MPB's Consolidated Financial Statements, which are incorporated herein by reference.

Banking regulators continue to indicate their desire to further develop capital requirements applicable to banking organizations. Changes to capital requirements could materially affect the profitability of MPB or the market value of MPB stock.

#### *FDIC Improvement Act*

As a result of the FDIC Improvement Act of 1991, banks are subject to increased reporting requirements and more frequent examinations by the bank regulatory agencies. The agencies also have the authority to dictate certain key decisions that formerly were left to management, including compensation standards, loan underwriting standards, asset growth, and payment of dividends. Failure to comply with these standards, or failure to maintain capital above specified levels set by the regulators, could lead to the imposition of penalties or the forced resignation of management. If a bank becomes critically undercapitalized, the banking agencies have the authority to place an institution into receivership.

#### *Safety and Soundness Standards*

Pursuant to FDICIA, the federal banking regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards for depository institutions such as the Bank. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the agencies adopted regulations that authorize an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If the institution fails to submit an acceptable compliance plan or fails to implement an accepted plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions be taken, including restricting asset growth, restricting interest rates paid on deposits, and requiring an increase in the institution's ratio of tangible equity to assets.

#### *Payment of Dividends and Other Restrictions*

MPB is a legal entity separate and distinct from its subsidiary, the Bank. There are various legal and regulatory limitations on the extent to which the Bank can, among other things, finance, or otherwise supply funds to, MPB. Specifically, dividends from the Bank are the principal source of

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

MPB's cash funds and there are certain legal restrictions under Pennsylvania law and Pennsylvania banking regulations on the payment of dividends by state-chartered banks. The relevant regulatory agencies also have authority to prohibit MPB and the Bank from engaging in what, in the opinion of such regulatory body, constitutes an unsafe or unsound banking practice. The payment of dividends could, depending upon the financial condition of MPB and the Bank, be deemed to constitute such an unsafe or unsound practice. Further, under the terms of the Capital Purchase Program, MPB is restricted from increasing its dividends on its common stock as long as the CPP preferred stock is outstanding.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

#### *Prompt Corrective Action*

In addition to the required minimum capital levels described above, federal law establishes a system of prompt corrective actions which Federal banking agencies are required to take, and certain actions which they have discretion to take, based upon the capital category into which a federally regulated depository institution falls. Regulations set forth detailed procedures and criteria for implementing prompt corrective action in the case of any institution, which is not adequately capitalized. Under the rules, an institution will be deemed to be adequately capitalized if it exceeds the minimum Federal regulatory capital requirements. However, it will be deemed undercapitalized if it fails to meet the minimum capital requirements, significantly undercapitalized if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0%, or a leverage ratio that is less than 3.0%, and critically undercapitalized if the institution has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

The prompt corrective action rules require an undercapitalized institution to file a written capital restoration plan, along with a performance guaranty by its holding company or a third party. In addition, an undercapitalized institution becomes subject to certain automatic restrictions including a prohibition on payment of dividends, a limitation on asset growth and expansion, in certain cases, a limitation on the payment of bonuses or raises to senior executive officers, and a prohibition on the payment of certain management fees to any controlling person. Institutions that are classified as undercapitalized are also subject to certain additional supervisory actions, including increased reporting burdens and regulatory monitoring, a limitation on the institution's ability to make acquisitions, open new branch offices, or engage in new lines of business, obligations to raise additional capital, restrictions on transactions with affiliates, and restrictions on interest rates paid by the institution on deposits. In certain cases, bank regulatory agencies may require replacement of senior executive officers or directors, or sale of the institution to a willing purchaser. If an institution is deemed critically undercapitalized and continues in that category for four quarters, the statute requires, with certain narrowly limited exceptions, that the institution be placed in receivership.

#### *Deposit Insurance*

The FDIC insures deposits of the Bank through the Bank Insurance Fund (BIF). The insurance assessments paid by an institution are to be based on the probability that the fund will incur a loss with respect to the institution. The FDIC has adopted deposit insurance regulations under which insured institutions are assigned a risk-weighted assessment multiplier based on regulatory CAMELS ratings, capital position, and certain financial ratios. Our current assessment, based upon the current assessment formula is .0766 basis points.

#### *Environmental Laws*

Management does not anticipate that compliance with environmental laws and regulations will have any material effect on MPB's capital, expenditures, earnings, or competitive position. However, environmentally related hazards have become a source of high risk and potentially unlimited liability for financial institutions.

In 1995, the Pennsylvania General Assembly enacted the Economic Development Agency, Fiduciary and Lender Environmental Liability Protection Act, which among other things, provides protection to lenders from environmental liability and remediation costs under the environmental laws for releases and contamination caused by others. A lender who engages in activities involved in the routine practices of commercial lending, including, but not limited to, the providing of financial services, holding of security interests, workout practices, foreclosure or the recovery of funds from the sale of property shall not be liable under the environmental acts or common law equivalents to the Pennsylvania Department of Environmental Resources or to any other person by virtue of the fact that the lender engages in such commercial lending practice. A lender, however, will be liable if it, its employees or agents, directly cause an immediate release or directly exacerbate a release of regulated substance on or from the property, or known and willfully compelled the borrower to commit an action which caused such release or violate an environmental act. The Economic Development Agency, Fiduciary and Lender Environmental Liability Protection Act does not limit federal liability which still exists under certain circumstances.

#### *Consumer Protection Laws*

A number of laws govern the relationship between the Bank and its customers. For example, the Community Reinvestment Act is designed to encourage lending by banks to persons in low and moderate income areas. The Home Mortgage Disclosure Act and the Equal Credit Opportunity Act attempt to minimize lending decisions based on impermissible criteria, such as race or gender. The Truth-in-Lending Act and the Truth-in-Savings Act require banks to provide certain disclosure of relevant terms related to loans and savings accounts, respectively.

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

Anti-tying restrictions (which prohibit conditioning the availability or terms of credit on the purchase of another banking product) further restrict the Bank's relationships with its customers.

### *Privacy Laws*

In 2000, the federal banking regulators issued final regulations implementing certain provisions of GLB governing the privacy of consumer financial information. The regulations limit the disclosure by financial institutions, such as MPB and the Bank, of nonpublic personal information about individuals who obtain financial products or services for personal, family, or household purposes. Subject to certain exceptions allowed by law, the regulations cover information sharing between financial institutions and nonaffiliated third parties. More specifically, the regulations require financial institutions to:

provide initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal financial information to nonaffiliated third parties and affiliates;



## **Table of Contents**

### **MID PENN BANCORP, INC.**

provide annual notices of their privacy policies to their current customers; and

provide a reasonable method for consumers to opt out of disclosures to nonaffiliated third parties.

#### *Protection of Customer Information*

In 2001, the federal banking regulators issued final regulations implementing the provisions of GLB relating to the protection of customer information. The regulations, applicable to the MPB and the Bank, relate to administrative, technical, and physical safeguards for customer records and information. These safeguards are intended to:

insure the security and confidentiality of customer records and information;

protect against any anticipated threats or hazards to the security or integrity of such records; and

protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any customer.

#### *Affiliate Transactions*

Transactions between MPB and the Bank and its affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a bank or savings institution is any company or entity that controls, is controlled by, or is under common control with the bank or savings institution. Generally, a subsidiary of a depository institution that is not also a depository institution is not treated as an affiliate of the bank for purposes of Sections 23A and 23B. Sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by limiting the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate and with all affiliates of the bank in the aggregate, and requiring that such transactions be on terms that are consistent with safe and sound banking practices.

Effective April 1, 2003, Regulation W of the Federal Reserve comprehensively amended Sections 23A and 23B. The regulation unifies and updates staff interpretations issued over the years, incorporates several new interpretative proposals (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate), and addresses new issues arising as a result of the expanded scope of non-banking activities engaged in by bank and bank holding companies in recent years and authorized for financial holding companies under the GLB.

#### *The USA Patriot Act*

In 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) was signed into law. The USA Patriot Act broadened the application of anti-money laundering regulations to apply to additional types of financial institutions, such as broker-dealers, and strengthened the ability of the U.S. government to detect and prosecute international money laundering and the financing of terrorism. The principal provisions of Title III of the USA Patriot Act require that regulated financial institutions, including state-chartered banks:

establish an anti-money laundering program that includes training and audit components;

comply with regulations regarding the verification of the identity of any person seeking to open an account;

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

take additional required precautions with non-U.S. owned accounts; and

perform certain verification and certification of money laundering risk for their foreign correspondent banking relationships.

The USA Patriot Act also expanded the conditions under which funds in a U.S. interbank account may be subject to forfeiture and increased the penalties for violation of anti-money laundering regulations. Failure of a financial institution to comply with the USA Patriot Acts requirements could have serious legal and reputational consequences for the institution. The Bank has adopted policies, procedures and controls to address compliance with the requirements of the USA Patriot Act under the existing regulations and will continue to revise and update its policies, procedures and controls to reflect changes required by the USA Patriot Act and implementing regulations.

### *Anti-Money Laundering and Anti-Terrorism Financing*

Under Title III of the USA PATRIOT Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions, including MPB and the Bank, are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Additional information-sharing among financial institutions, regulators, and law enforcement authorities is encouraged by the presence of an exemption from the privacy provisions of the GLB Act for financial institutions that comply with this provision and the authorization of the Secretary of the Treasury to adopt rules to further encourage cooperation and information-sharing. The effectiveness of a financial institution in combating money-laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank.

---

**Table of Contents**

**MID PENN BANCORP, INC.**

*Effects of Government Policy and Potential Changes in Regulation*

Changes in regulations applicable to MPB or the Bank, or shifts in monetary or other government policies, could have a material affect on our business. MPB's and the Bank's business is also affected by the state of the financial services industry in general. As a result of legal and industry changes, management believes that the industry will continue to experience an increased rate of change as the financial services industry strives for greater product offerings, market share and economies of scale.

From time to time, legislation is enacted that has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, and before various bank regulatory agencies. MPB cannot predict the likelihood of any major changes or the impact such changes might have on MPB and/or the Bank. Various congressional bills and other proposals have proposed a sweeping overhaul of the banking system, including provisions for: limitations on deposit insurance coverage; changing the timing and method financial institutions use to pay for deposit insurance; expanding the power of banks by removing the restrictions on bank underwriting activities; and tightening the regulation of bank derivatives activities; and allowing commercial enterprises to own banks.

MPB's earnings are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The monetary policies of the Federal Reserve have had, and will likely continue to have, an impact on the operating results of commercial banks because of the Federal Reserve's power to implement national monetary policy to, among other things, curb inflation or combat recession. The Federal Reserve has a major impact on the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of, among other things, the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature and impact of future changes in monetary and fiscal policies.

From time to time, various types of federal and state legislation have been proposed that could result in additional regulation of, and restrictions on, the business of the Bank. It cannot be predicted whether any such legislation will be adopted or how such legislation would affect the business of the Bank. As a consequence of the extensive regulation of commercial banking activities in the United States, the Bank's business is particularly susceptible to being affected by federal legislation and regulations that may increase the costs of doing business.

*Recent Developments*

The global and U.S. economies are experiencing significantly reduced business activity as a result of disruptions in the financial system during the past year. Dramatic declines in the housing market during the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail.

Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers, including other financial institutions. The availability of credit, confidence in the financial sector, and level of volatility in the financial markets have been significantly adversely affected as a result. In the latter part of 2008, volatility and disruption in the capital and credit markets has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength.

In response to the financial crises affecting the banking system and financial markets, and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. Pursuant to the EESA, the U.S. Treasury will have the authority to purchase up to \$700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. The EESA included a provision for a temporary increase in FDIC insurance from \$100,000 to \$250,000 per depositor through December 31, 2009.

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

On October 14, 2008, the Secretary of the Treasury, after consulting with the Federal Reserve and the FDIC, announced that the Department of the Treasury will purchase equity stakes in a wide variety of banks and thrifts. Under this program, known as the Troubled Asset Relief Program ( TARP ) Capital Purchase Program, from the \$700 billion authorized by the EESA, the Treasury made \$250 billion of capital available to U.S. financial institutions in the form of preferred stock. In conjunction with the purchase of preferred stock, the Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15% of the preferred investment. Participating financial institutions will be required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under TARP Capital Purchase Program.

Also on October 14, 2008, after receiving a recommendation from the boards of the FDIC and the Federal Reserve, and consulting with the President, the Secretary of the Treasury signed the systemic risk exception to the FDIC Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior debt of all FDIC-insured institutions and their holding companies, as well as deposits in non-interest bearing transaction

## **Table of Contents**

### **MID PENN BANCORP, INC.**

deposit accounts under a Temporary Liquidity Guarantee Program. Coverage under the Temporary Liquidity Guarantee Program was available until November 12, 2008 without charge and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for non-interest bearing transaction deposits. Participating under the Capital Purchase Program, the Company sold \$10,000,000 in Series A Fixed Rate Cumulative Perpetual Preferred Stock to the United States Department of the Treasury on December 19, 2008. For more information about the Company's participation, please see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Capital Purchase Program Participation.

It is not clear at this time what impact the EESA, TARP Capital Purchase Program, the Temporary Liquidity Guarantee Program, other liquidity and funding initiatives of the Federal Reserve and other agencies that have been previously announced, and any additional programs that may be initiated in the future will have on the financial markets and the other difficulties described above, including the extreme levels of volatility and limited credit availability currently being experienced, or on the U.S. banking and financial industries and the broader U.S. and global economies. Further adverse effects could have a material impact on the Company and its business.

The American Recovery and Reinvestment Act of 2009 amended the Emergency Economic Stabilization Act of 2008 as it applies to institutions that received financial assistance under the Troubled Asset Relief Program. As an institution that received financial assistance under this program, MPB is subject to the executive compensation and corporate governance requirements contained in the Emergency Economic Stabilization Act of 2008, as amended, which are more fully discussed in Item 7 on page 31.

### **Available Information**

Mid Penn Bancorp Inc.'s common stock is registered under Section 12(b) of the Securities Exchange Act of 1934 and is traded on the NASDAQ Stock Market under the trading symbol MPB. Mid Penn Bancorp, Inc. is subject to the informational requirements of the Exchange Act, and, accordingly, files reports, proxy statements and other information with the Securities and Exchange Commission. The reports, proxy statements and other information filed with the SEC are available for inspection and copying at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. Mid Penn Bancorp, Inc. is an electronic filer with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's Internet site address is [www.sec.gov](http://www.sec.gov).

MPB's headquarters are located at 349 Union Street, Millersburg, Pennsylvania 17061, and its telephone number is (717) 692-2133. MPB's Internet address is [www.midpennbank.com](http://www.midpennbank.com). MPB makes available through its website, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as reasonably practicable after filing with the Securities and Exchange Commission. MPB has adopted a Code of Ethics that applies to all employees. This document is also available on MPB's website. The information included on our website is not a part of this document.

### **ITEM 1A. RISK FACTORS**

*Future dividend payments and common stock repurchases are restricted by the terms of the U.S. Treasury's equity investment in MPB*

Under the terms of the CPP, for so long as any preferred stock issued under the CPP remains outstanding, MPB is prohibited from increasing dividends to holders of its common stock, and from making certain repurchases of equity securities, including our common stock, without the U.S. Treasury's consent until the third anniversary of the U.S. Treasury's investment or until the U.S. Treasury has transferred all of the preferred stock it purchased under the CPP to third parties. As long as the preferred stock issued to the U.S. Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including MPB's common stock, are prohibited until all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions.

#### *MPB Is Subject To Interest Rate Risk*

MPB's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond MPB's control, including general economic conditions and

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

policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest MPB receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) MPB's ability to originate loans and obtain deposits, (ii) the fair value of MPB's financial assets and liabilities, and (iii) the average duration of MPB's mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, MPB's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

Management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on MPB's results of operations. Any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on MPB's financial condition and results of operations.

#### *MPB Is Subject To Lending Risk*

As of December 31, 2008, approximately 70.4% of MPB's loan portfolio consisted of commercial and industrial, construction and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because MPB's loan portfolio contains a significant number of commercial and industrial, construction and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan and lease losses and an increase in loan charge-offs, all of which could have a material adverse effect on MPB's financial condition and results of operations.

#### *MPB's Allowance For Possible Loan and Lease Losses May Be Insufficient*

MPB maintains an allowance for possible loan and lease losses, which is a reserve established through provisions for possible losses charged to expense, that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan and lease losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for possible loan and lease losses inherently involves a high degree of subjectivity and requires MPB to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem credits and other factors, both within and outside of MPB's control, may require an increase in the allowance. In addition, bank regulatory agencies periodically review MPB's and may require an increase in the provision for possible loan and lease losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance, MPB will need additional provisions to increase the allowance for possible loan and lease losses. Any increases in the allowance will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on MPB's financial condition and results of operations.

#### *Competition from other financial institutions may adversely affect MPB's profitability*

MPB's banking subsidiary faces substantial competition in originating, both commercial and consumer loans. This competition comes principally from other banks, savings institutions, mortgage banking companies and other lenders. Many of its competitors enjoy advantages, including greater financial resources and higher lending limits, a wider geographic presence, more accessible branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. This competition could reduce the Corporation's net income by decreasing the number and size of loans that its banking subsidiary originates and the interest rates it may charge on these loans.

In attracting business and consumer deposits, its banking subsidiary faces substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of MPB's competitors enjoy advantages, including greater financial resources, more aggressive marketing campaigns, better brand recognition and more convenient branch locations. These competitors may offer higher interest rates than MPB, which could decrease the deposits that MPB attracts or require MPB to increase its rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect MPB's ability to generate the funds necessary for lending operations. As a result, MPB may need to seek other sources of funds that may be more expensive to obtain and could increase its cost of funds.

MPB's banking subsidiary also competes with non-bank providers of financial services, such as brokerage firms, consumer finance companies, credit unions, insurance agencies and governmental organizations, which may offer more favorable terms. Some of its non-bank competitors are not subject to the same extensive regulations that govern its banking operations. As a result, such non-bank competitors may have advantages over MPB's banking subsidiary in providing certain products and services. This competition may reduce or limit MPB's margins on banking services, reduce its market share and adversely affect its earnings and financial condition.

*MPB's Controls and Procedures May Fail or Be Circumvented*

Management regularly reviews and updates MPB's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of MPB's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on MPB's business, results of operations, and financial condition.



---

**Table of Contents**

**MID PENN BANCORP, INC.**

*MPB's ability to pay dividends depends primarily on dividends from its banking subsidiary, which is subject to regulatory limits*

MPB is a bank holding company and its operations are conducted by its subsidiaries. Its ability to pay dividends depends on its receipt of dividends from its subsidiaries. Dividend payments from its banking subsidiary are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by the various banking regulatory agencies. The ability of MPB's subsidiaries to pay dividends is also subject to their profitability, financial condition, capital expenditures and other cash flow requirements. There is no assurance that MPB's subsidiaries will be able to pay dividends in the future or that MPB will generate adequate cash flow to pay dividends in the future. MPB's failure to pay dividends on its common stock could have a material adverse effect on the market price of its common stock.

*MPB May Not Be Able To Attract and Retain Skilled People*

MPB's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by MPB can be intense and MPB may not be able to hire people or to retain them. The unexpected loss of services of one or more of MPB's key personnel could have a material adverse impact on MPB's business because of their skills, knowledge of MPB's market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel. Other than a Change of Control Agreement with the Chief Financial Officer, MPB does not currently have employment or non-competition agreements with any of its other senior officers.

*MPB Is Subject To Claims and Litigation Pertaining To Fiduciary Responsibility*

From time to time, customers make claims and take legal action pertaining to MPB's performance of its fiduciary responsibilities. Whether customer claims and legal action related to MPB's performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to MPB they may result in significant financial liability and/or adversely affect the market perception of MPB and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on MPB's business, which, in turn, could have a material adverse effect on MPB's financial condition and results of operations.

*The Trading Volume In MPB's Common Stock Is Less Than That Of Other Larger Financial Services Companies*

MPB's common stock is listed for trading on NASDAQ; the trading volume in its common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of MPB's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which MPB has no control. Given the lower trading volume of MPB's common stock, significant sales of MPB's common stock, or the expectation of these sales, could cause MPB's stock price to fall.

*MPB operates in a highly regulated environment and may be adversely affected by changes in federal, state and local laws and regulations*

MPB is subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal, state or local legislation could have a substantial impact on MPB and its operations. Additional legislation and regulations that could significantly affect MPB's powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on its financial condition and results of operations. Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have a negative impact on MPB's results of operations and financial condition.

MPB must comply with significant anti-money laundering and anti-terrorism laws. Under these laws, MPB is required, among other things, to enforce a customer identification program and file currency transaction and suspicious activity reports with the federal government. Government agencies have substantial discretion to impose significant monetary penalties on institutions, which fail to comply with these laws or make required reports.

*The soundness of other financial institutions may adversely affect MPB*

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

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. MPB has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose MPB to credit risk in the event of a default by a counterparty or client. In addition, MPB's credit risk may be exacerbated when the collateral held by MPB cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to MPB. Any such losses could have a material adverse affect on the MPB's financial condition and results of operations.

*Current levels of market volatility are unprecedented and may have materially adverse effects on our liquidity and financial condition*

The capital and credit markets have been experiencing extreme volatility and disruption for more than 12 months. In recent weeks, the volatility and disruption have reached unprecedented levels. In some cases, the markets have exerted downward pressure on stock prices, security prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength. If the current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience adverse effects, which may be material, on our liquidity, financial condition, and profitability.

**Table of Contents****MID PENN BANCORP, INC.****ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

With the exception of the Market Square Office in Harrisburg, PA, the Bank owns its main office, branch offices and certain parking facilities related to its banking offices, all of which are free and clear of any lien. The Bank's main office and all branch offices are located in Pennsylvania. The table below sets forth the location of each of the Bank's properties.

<b>Property Location</b>	<b>Description of Property</b>
Main Office	Main Bank Office
349 Union Street	
Millersburg, PA 17061	
Elizabethville Branch Office	Branch Bank
4642 State Route 209	
Elizabethville, PA 17023	
Dalmatia Branch Office	Branch Bank
School House Road	
Dalmatia, PA 17017	
Carlisle Pike Branch Office	Branch Bank
4622 Carlisle Pike	
Mechanicsburg, PA 17050	
Harrisburg Branch Office	Branch Bank
4098 Derry Street	
Harrisburg, PA 17111	
Harrisburg Branch Office	Branch Bank
2615 North Front Street	
Harrisburg, PA 17110	
Tower City Branch Office	Branch Bank
545 East Grand Avenue	

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

Tower City, PA 17980

Dauphin Branch Office

Branch Bank

1001 Peters Mountain Road

Dauphin, PA 17018

Miners-Lykens Branch Office

Branch Bank

550 Main Street

Lykens, PA 17048

Allentown Boulevard Office

5500 Allentown Boulevard

Harrisburg, PA 17112

Branch Bank

Market Square Office

17 N. Second Street

Harrisburg, PA 17101

Branch Bank

**Table of Contents**

**MID PENN BANCORP, INC.**

Steelton Office	Branch Bank
51 South Front Street	
Steelton, PA 17113	
Middletown Office	Branch Bank
1100 Spring Garden Drive	
Middletown, PA 17057	
Camp Hill Office	Branch Bank
2101 Market Street	
Camp Hill, PA 17011	
Operations Center	Operations Center
906 N. River Road	
Halifax, PA 17032	
All of these properties are in good condition and are deemed by management to be adequate for the bank's purposes.	

**ITEM 3. LEGAL PROCEEDINGS**

Management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of the company. MPB and the Bank have no proceedings pending other than ordinary routine litigation occurring in the normal course of business. In addition, management does not know of any material proceedings contemplated by governmental authorities against MPB or the Bank or any of its properties.

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

On December 10, 2008, Mid Penn held a special meeting of shareholders to approve and adopt an amendment to the articles of incorporation to provide for up to 10,000,000 shares of preferred shares to be issued. The amendment was approved and adopted by the shareholders pursuant to the following vote totals:

Votes for the proposal	2,280,861
Votes against the proposal	98,037
Abstentions and broker non-votes	2,916

**Table of Contents**

MID PENN BANCORP, INC.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The Company's common stock is traded on the NASDAQ Stock Market under the symbol MPB. The following table shows the range of high and low sale prices for the Company's stock and cash dividends paid for the quarters indicated.

	High	Low	Cash Dividends Paid
Quarter Ended:			
March 31, 2008	\$ 26.70	\$ 23.00	\$ 0.20
June 30, 2008	27.50	22.85	0.20
September 30, 2008	25.85	21.60	0.20
December 31, 2008	24.00	14.75	0.20
March 31, 2007	\$ 25.45	\$ 23.15	\$ 0.20
June 30, 2007	26.86	22.00	0.20
September 30, 2007	26.50	23.70	0.20
December 31, 2007	27.10	23.75	0.20

Transfer Agent: Registrar and Transfer Company, 10 Commerce Drive, Cranford, NJ 07016. Phone: 1-800-368-5948.

Number of Stockholders: As of February 6, 2009, there were approximately 1,489 shareholders of record of MPB's common stock.

Dividends: A dividend of \$.20 per share was paid during each quarter of 2008 and 2007. Mid Penn Bancorp, Inc. plans to continue a quarterly dividend payable in February, May, August and November. Additionally, a 5% stock dividend was paid in May of 2007.

Dividend Reinvestment and Stock Purchases: Stockholders of Mid Penn Bancorp, Inc. may acquire additional shares of common stock by reinvesting their cash dividends under the Dividend Reinvestment Plan without paying a brokerage fee. Voluntary cash contributions may also be made under the Plan. For additional information about the Plan, contact the Transfer Agent.

Annual Meeting: The Annual Meeting of the Stockholders of Mid Penn Bancorp, Inc. will be held at 10:00 a.m. on Tuesday, April 28, 2009, at 349 Union Street, Millersburg, Pennsylvania.

Accounting, Auditing and Internal Control Complaints: Information on how to report a complaint regarding accounting, internal accounting controls or auditing matters is available at Mid Penn Bank's website: [www.midpennbank.com](http://www.midpennbank.com).

**Table of Contents**

**MID PENN BANCORP, INC.**

**Stock Performance Graph**

<i>Index</i>	<i>Period Ending</i>					
	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08
Mid Penn Bancorp, Inc.	100.00	123.21	116.80	126.63	144.70	116.69
NASDAQ Composite	100.00	108.59	110.08	120.56	132.39	78.72
Mid-Atlantic Custom Peer Group*	100.00	113.29	113.25	115.44	107.89	83.30

\* *Mid-Atlantic Custom Peer Group consists of Mid-Atlantic commercial banks with assets less than \$1B.*

**Source : SNL Financial LC, Charlottesville, VA**

**© 2009**

A detailed list of the Banks comprising the Mid-Atlantic Custom Peer Group is incorporated herein by reference to Exhibit 99.1, which is attached to this Annual Report on Form 10-K.

**Table of Contents****MID PENN BANCORP, INC.****ITEM 6. SELECTED FINANCIAL DATA**Summary of Selected Financial Data

(Dollars in thousands, except per share data)

	2008	2007	2006	2005	2004
<b>INCOME:</b>					
Total Interest Income	\$ 31,856	\$ 31,444	\$ 28,214	\$ 23,294	\$ 20,077
Total Interest Expense	14,890	15,339	12,732	9,557	8,005
Net Interest Income	16,966	16,105	15,482	13,737	12,072
Provision for Possible Loan and Lease Losses	1,230	925	735	225	725
Noninterest Income	3,682	3,481	3,028	2,953	3,457
Noninterest Expense	14,726	12,596	11,263	10,262	9,030
Income Before Income Taxes	4,692	6,065	6,512	6,203	5,774
Provision for Income Taxes	1,104	1,394	1,624	1,600	1,405
Net Income	3,588	4,671	4,888	4,603	4,369
<b>COMMON STOCK DATA PER SHARE:</b>					
Earnings Per Share (Basic)	\$ 1.03	\$ 1.34	\$ 1.39	\$ 1.31	\$ 1.24
Earnings Per Share (Fully Diluted)	1.03	1.34	1.39	1.31	1.24
Cash Dividends Declared, historical	0.80	0.80	0.80	0.80	1.80
Stockholders' Equity	14.61	11.56	11.12	10.48	10.03
AVERAGE SHARES OUTSTANDING (BASIC)	3,483,097	3,497,806	3,514,820	3,515,714	3,515,726
AVERAGE SHARES OUTSTANDING (FULLY DILUTED)	3,483,153	3,497,806	3,514,820	3,515,714	3,515,726
<b>AT YEAR-END:</b>					
Investments	\$ 52,739	\$ 50,250	\$ 57,261	\$ 54,549	\$ 44,613
Loans and Leases, Net of Unearned Discount	434,643	377,128	358,612	311,837	279,547
Allowance for Loan and Lease Losses	5,505	4,790	4,187	3,704	3,643
Total Assets	572,300	509,757	491,694	438,110	403,256
Total Deposits	436,824	372,817	364,226	325,274	301,144
Short-term Borrowings	23,977	37,349	24,275	12,342	13,801
Long-term Debt	55,223	54,581	59,713	59,838	49,957
Stockholders' Equity	50,890	40,444	39,085	36,861	35,272
<b>RATIOS:</b>					
Return on Average Assets	0.67%	0.94%	1.08%	1.10%	1.12%
Return on Average Stockholders' Equity	8.83%	11.84%	12.93%	12.87%	12.73%
Cash Dividend Payout Ratio	77.67%	59.70%	54.79%	55.56%	131.38%
Allowance for Loan and Lease Losses to Loans and Leases	1.27%	1.27%	1.17%	1.19%	1.30%
Average Stockholders' Equity to Average Assets	7.55%	7.82%	8.34%	8.55%	8.75%



---

**Table of Contents**

**MID PENN BANCORP, INC.**

**Management's Discussion and Analysis**

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
**SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS**

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

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

the effects of future economic conditions on MPB and the Bank's customers;

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

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

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

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

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

technological changes;

acquisitions and integration of acquired businesses;

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

acts of war or terrorism; and

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

disruption of credit and equity markets.

All written or oral forward-looking statements attributable to MPB are expressly qualified in their entirety by these cautionary statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of MPB's consolidated financial statements and should be read in conjunction with the Consolidated Financial Statements of the Company and Notes thereto and other detailed information appearing elsewhere in this Annual Report. MPB is not aware of any known trends, events, uncertainties or of any current recommendations by the regulatory authorities which, if they were to be implemented, would have a material effect on MPB's liquidity, capital resources or operations.

### Financial Summary

The consolidated earnings of MPB are derived primarily from the operations of its wholly owned subsidiary, Mid Penn Bank.

MPB earned net income of \$3,588,000 for the year 2008, compared to \$4,671,000 in 2007, which was a decrease of \$1,083,000 or 23.2%. This represents net income in 2008 of \$1.03 per share compared to \$1.34 per share in 2007 and \$1.39 per share in 2006.

Total assets of MPB continued to grow in 2008, reaching the level of \$572,300,000, an increase of \$62,543,000 or 12.3% over \$509,757,000 at year-end 2007. The majority of growth came from increases in commercial real estate loans in the Capital Region. These increases were funded primarily through growth in deposits.

MPB's return on average shareholders' equity, (ROE), a widely recognized performance indicator in the financial industry, was 8.83% in 2008, 11.84% in 2007 and 12.93% in 2006. Return on average assets (ROA), another performance indicator, was 0.67% in 2008, 0.94% in 2007 and 1.08% in 2006.

MPB's performance during 2008 was adversely impacted by several factors. First is the declining interest rate environment that persisted throughout the year. While MPB exhibited strong growth in both loans and deposits, the Federal Reserve's program of interest rate cuts to spur a loosening of the credit markets blunted the benefit of this growth. MPB's net interest margin declined to 3.50% in 2008 from 3.68% in 2007. Net interest income rose a modest \$786,000 or 4.6% over 2007 levels in spite of a 9.9% increase in average earning assets.

Secondly, was the recording of severance expenses amounting to \$478,000, related to the departure in October of the former CEO.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Management's Discussion and Analysis**

Thirdly, was an increase in provision for loan and lease losses, driven by the spreading weakness in the economy and the downturn in real estate values, which management considered in its portfolio reviews, and the continued strong growth in loan volumes, particularly from the Capital region of the company. Further discussion of this increase can be found in the Provision for Loan and Lease Losses section below.

Finally, 2008 was impacted by a write-down of other real estate assets to better align these properties with current market prices. A charge of \$281,000 was recorded during the year to reflect these eroding market values.

MPB's fundamental performance in 2008 was strong despite these issues and the general economic slowing and credit crisis issues experienced by the banking industry as a whole. MPB's ongoing investment in marketing and business development in 2008 and 2007 was rewarded with strong growth in loans and deposits in its markets. MPB did not participate in subprime lending and fared better than many banks in the industry faced with problems associated with these lending practices during 2008.

The Bank's tier one capital (to risk weighted assets) of \$39,975,000 or 9.3% and total capital (to risk weighted assets) of \$45,376,000 or 10.5% at December 31, 2008, are above the regulatory requirements, which is 4% for tier one capital and 8% for total capital. Tier one capital consists primarily of the bank's stockholders' equity. Total capital includes qualifying subordinated debt, if any, and the allowance for loan and lease losses, within permitted limits. Risk-weighted assets are determined by assigning various levels of risk to different categories of assets and off-balance sheet activities.

### **Critical Accounting Policies**

Management of the Company considers the accounting policy relating to the allowance for loan and lease losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover credit losses inherent in the loan and lease portfolio and the material effect that such judgments can have on the results of operations. While management's current evaluation of the allowance indicates that the allowance is adequate, under adversely different conditions or assumptions, the allowance may need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provisions for loan losses may be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Company's non-performing loans and potential problem loans have a significant impact on the overall analysis of the adequacy of the allowance. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral evaluations were significantly lowered, the Company's allowance may also require additional provisions for loan and lease losses.

### **Net Interest Income**

Net interest income, MPB's primary source of revenue, represents the difference between interest income and interest expense. Net interest income is affected by changes in interest rates and changes in average balances (volume) in the various interest-sensitive assets and liabilities.

During 2008, net interest income increased \$786,000 or 4.6% as compared to an increase of \$756,000 or 4.6% in 2007. The average balances, effective interest differential, and interest yields for the years ended December 31, 2008, 2007, and 2006 and the components of net interest income, are presented in Table 1. A comparative presentation of the changes in net interest income for 2008 compared to 2007, and 2007 compared to 2006, is given in Table 2. This analysis indicates the changes in interest income and interest expense caused by the volume and rate components of interest earning assets and interest bearing liabilities.

The yield on earning assets decreased to 6.42% in 2008 from 6.98% in 2007. The yield on earning assets for 2006 was 6.80%. The change in the yield on earning assets was due primarily to changes in market interest rates and extreme rate competition within our market. The average prime rate for 2008 was 5.09% as compared to 8.06% for 2007 and 7.96% for 2006. The yield on earning assets is also negatively impacted by the loss of interest on nonperforming loans. During 2008, this loss of interest amounted to \$335,000. Had this revenue been included in MPB's earnings, the yield on earning assets would have increased 0.07%.

Interest expense decreased by \$449,000, or 2.9%, in 2008 as compared to an increase of \$2,607,000, or 20.5%, in 2007. The cost of interest bearing liabilities decreased to 3.35% in 2008 from 3.76% in 2007. The cost of interest bearing liabilities for 2006 was 3.45%. The reduction in cost of interest bearing liabilities was due to changes in market interest rates and MPB's ability to reduce the rates on Money Market accounts and Certificates of Deposit. The reduction in market interest rates also had a positive impact on MPB's cost for short-term borrowings.

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

Net interest margin, on a tax equivalent basis, influenced by fluctuations in interest rates in 2008 was 3.50% compared to 3.68% in 2007 and 3.81% in 2006. Management continues to monitor the net interest margin closely.

**Table of Contents**

MID PENN BANCORP, INC.

Management's Discussion and Analysis

**TABLE 1: AVERAGE BALANCES, EFFECTIVE INTEREST DIFFERENTIAL AND INTEREST YIELDS**

Income and Rates on a Taxable Equivalent Basis for Years Ended

(Dollars in thousands)

	December 31, 2008			December 31, 2007			December 31, 2006		
	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates
<b>ASSETS:</b>									
Interest Earning Balances	\$ 54,804	\$ 2,499	4.56%	\$ 46,900	\$ 2,546	5.43%	\$ 46,038	\$ 2,225	4.83%
<b>Investment Securities:</b>									
Taxable	19,870	831	4.18%	21,709	959	4.42%	24,138	1,044	4.33%
Tax-Exempt	27,287	1,895	6.94%	29,726	2,062	6.94%	28,402	1,950	6.87%
Total Securities	47,157			51,435			52,540		
Federal Funds Sold				624	33	5.29%	564	29	5.14%
<b>Loans and Leases, Net:</b>									
Taxable	394,674	26,713	6.77%	361,324	26,592	7.36%	324,720	23,598	7.27%
Tax-Exempt	8,994	648	7.20%						
Total Loans and Leases, Net	403,668			361,324			324,720		
Restricted Investment in Bank Stocks	3,657	134	3.66%	3,334	191	5.73%	3,205	174	5.43%
Total Earning Assets	509,286	32,720	6.42%	463,617	32,383	6.98%	427,067	29,020	6.80%
Cash and Due from Banks	7,745			7,559			7,000		
Other Assets	21,326			25,012			19,100		
Total Assets	\$ 538,357			\$ 496,188			\$ 453,167		
<b>LIABILITIES &amp; STOCKHOLDERS</b>									
<b>EQUITY:</b>									
<b>Interest Bearing Deposits:</b>									
NOW	\$ 36,551	\$ 108	0.30%	\$ 35,048	\$ 144	0.41%	\$ 31,877	\$ 90	0.28%
Money Market	69,251	1,456	2.10%	63,927	2,208	3.45%	60,968	1,898	3.11%
Savings	25,607	65	0.25%	25,513	72	0.28%	24,772	61	0.25%
Time	230,773	9,903	4.29%	203,671	9,006	4.42%	172,792	6,819	3.95%
Short-term Borrowings	29,144	608	2.09%	22,528	1,049	4.66%	14,937	686	4.59%
Long-term Debt	52,843	2,750	5.20%	56,908	2,860	5.03%	63,329	3,178	5.02%
Total Interest Bearing Liabilities	444,169	14,890	3.35%	407,595	15,339	3.76%	368,675	12,732	3.45%
Demand Deposits	47,274			44,021			43,161		
Other Liabilities	6,456			5,734			3,527		
Stockholders' Equity	40,458			38,838			37,804		
	\$ 538,357			\$ 496,188			\$ 453,167		

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

Total Liabilities and Stockholders  
Equity

Net Interest Income	\$ 17,830	\$ 17,044	\$ 16,288
---------------------	-----------	-----------	-----------

Net Yield on Interest Earning Assets:

Total Yield on Earning Assets	6.42%	6.98%	6.80%
Rate on Supporting Liabilities	3.35%	3.76%	3.45%
Average Interest Spread	3.07%	3.22%	3.34%
Net Interest Margin	3.50%	3.68%	3.81%

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

Interest and average rates are presented on a fully taxable equivalent basis, using an effective tax rate of 34%. For purposes of calculating loan yields, average loan balances include nonaccrual loans.

Loan fees of \$637,000, \$604,000 and \$748,000 are included with interest income in Table 1 for the years 2008, 2007 and 2006, respectively.

**TABLE 2: VOLUME ANALYSIS OF CHANGES IN NET INTEREST INCOME**

(Dollars in thousands)

	2008 Compared to 2007			2007 Compared to 2006		
	Increase (Decrease) Due to Change In:			Increase (Decrease) Due to Change In:		
<i>Taxable Equivalent Basis</i>	Volume	Rate	Net	Volume	Rate	Net
<b>INTEREST INCOME:</b>						
Interest Bearing Balances	\$ 429	\$ (476)	\$ (47)	\$ 42	\$ 279	\$ 321
<b>Investment Securities:</b>						
Taxable	(81)	(47)	(128)	(105)	20	(85)
Tax-Exempt	(169)	2	(167)	91	21	112
Total Investment Securities	(250)	(45)	(295)	(14)	41	27
Federal Funds Sold	(33)		(33)	3	1	4
Loans and Leases, Net	3,116	(2,347)	769	2,661	333	2,994
Restricted Investment Bank Stocks	19	(76)	(57)	7	10	17
Total Interest Income	3,281	(2,944)	337	2,699	664	3,363
<b>INTEREST EXPENSE:</b>						
Interest Bearing Deposits:						
NOW	6	(42)	(36)	9	45	54
Money Market	184	(936)	(752)	92	218	310
Savings		(7)	(7)	2	9	11
Time	1,198	(301)	897	1,220	967	2,187
Total Interest Bearing Deposits	1,388	(1,286)	102	1,323	1,239	2,562
Short-term Borrowings	308	(749)	(441)	348	15	363
Long-term Debt	(204)	94	(110)	(322)	4	(318)
Total Interest Expense	1,492	(1,941)	(449)	1,349	1,258	2,607
<b>NET INTEREST INCOME</b>	<b>\$ 1,789</b>	<b>\$ (1,003)</b>	<b>\$ 786</b>	<b>\$ 1,350</b>	<b>\$ (594)</b>	<b>\$ 756</b>

The effect of changing volume and rate has been allocated entirely to the rate column. Tax-exempt income is shown on a tax equivalent basis assuming a federal income tax rate of 34%.

**Provision for Loan and Lease Losses**

The provision for loan and lease losses charged to operating expense represents the amount deemed appropriate by management to maintain an adequate allowance for possible loan and lease losses. Following its model for loan and lease loss allowance adequacy, management made a \$1,230,000 provision in 2008, as well as a provision of \$925,000 in 2007, and \$735,000 in 2006. The allowance for loan and lease losses as a

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

percentage of total loans was 1.27% at December 31, 2008, compared to 1.27% at December 31, 2007, and 1.17% at December 31, 2006, which has been higher than that of peer financial institutions due to MPB's higher level of loans to finance commercial real estate. The higher 2008 provision was due to ongoing concern surrounding the deteriorating health of the overall economy and the volume of nonperforming loans continuing to be at levels higher than historically experienced. The robust growth in the loan portfolio during 2008 also contributed to the increased level of provision for the year. A summary of charge-offs and recoveries of loans and leases are presented in Table 3.



**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis****TABLE 3: ANALYSIS OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES**

(Dollars in thousands)

	Years ended December 31,				
	2008	2007	2006	2005	2004
Balance, beginning of year	\$ 4,790	\$ 4,187	\$ 3,704	\$ 3,643	\$ 2,992
Loans and leases charged off:					
Commercial real estate, construction and land development	384		17	32	25
Commercial, industrial and agricultural	70	100	158	29	10
Real estate residential					8
Consumer	188	231	134	138	78
Leases	5	129			
Total loans and leases charged off	647	460	309	199	121
Recoveries on loans and leases previously charged off:					
Commercial real estate, construction and land development	1				
Commercial, industrial and agricultural	20	5	3	12	8
Real estate residential					
Consumer	111	49	54	23	39
Leases		84			
Total loans and leases recovered	132	138	57	35	47
Net charge-offs	515	322	252	164	74
Provision for loan and lease losses	1,230	925	735	225	725
Balance, end of year	\$ 5,505	\$ 4,790	\$ 4,187	\$ 3,704	\$ 3,643
Ratio of net charge-offs during the year to average loans and leases outstanding during the year, net of unearned discount	0.13%	0.09%	0.08%	0.06%	0.03%
Allowance for loan and lease losses as a percentage of total loans and leases at December 31, 2008	1.27%	1.27%	1.17%	1.18%	1.30%
Allowance for loan and lease losses as a percentage of non-performing assets at December 31, 2008	73.01%	65.23%	172.02%	111.67%	205.24%

**Noninterest Income**

A summary of the major components of noninterest income for the years ended December 31, 2008, 2007, and 2006 is found in Table 4. During 2008, MPB earned \$3,682,000 in noninterest income, compared to \$3,481,000 earned in 2007 and \$3,028,000 earned in 2006.

Service charges on deposit accounts amounted to \$1,654,000 for 2008, an increase of \$155,000 or 10.3% compared to \$1,499,000 for 2007, which was an increase of \$123,000 or 8.9% above 2006. The majority of this increase is attributable to the general growth in transaction accounts during 2008.

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

MPB owns cash surrender value of life insurance policies on its directors. The income on these policies amounted to \$267,000 during the year 2008, \$271,000 in 2007, and \$219,000 in 2006.

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

Trust department income for 2008 was \$313,000, a \$6,000 or 1.9% decrease from \$319,000 in 2007, which was a \$61,000 or 23.6% increase from \$258,000 in 2006. Trust Department income can fluctuate from year to year, due to the number of estates settled during the year.

Significant revenue originated from our portfolio of ATM and debit cards. This is in the form of interchange fees generated by cardholder transactions. During 2008, MPB switched its third-party card processor, generating increased revenue, which coupled with increasing customer usage led to earnings of \$375,000, a \$44,000 or 13.3% increase from \$331,000 in 2007, which was a \$60,000 increase from 2006.

MPB also earned \$175,000 in 2008, \$155,000 in 2007, and \$112,000 in 2006 in fees from the third-party seller of investments whose services the Bank has contracted.

Other income amounted to \$726,000 in 2008, \$746,000 in 2007, and \$633,000 in 2006.

**TABLE 4: NONINTEREST INCOME**

(Dollars in thousands)

	<b>Years ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Trust department income	\$ 313	\$ 319	\$ 258
Service charges on deposits	1,654	1,499	1,376
Investment securities gains, net	9		33
Increase in bank-owned life insurance	267	271	219
Mortgage banking income	163	160	126
ATM debit card interchange income	375	331	271
Retail investment revenue	175	155	112
Other	726	746	633
<b>Total Noninterest Income</b>	<b>\$ 3,682</b>	<b>\$ 3,481</b>	<b>\$ 3,028</b>

**Noninterest Expense**

A summary of the major components of noninterest expense for the years ended December 31, 2008, 2007, and 2006 is reflected in Table 5. Noninterest expense increased to \$14,726,000 in 2008 from \$12,596,000 in 2007 and \$11,263,000 in 2006.

The major component of noninterest expense is salaries and employee benefits. The number of full-time equivalent employees increased from 143 to 152 during 2008. Increases in the 2008 workforce primarily included additions to support functions within the company, in order to support future growth. MPB also recognized a full year of salaries and employee benefits following the acquisition of the Camp Hill office during September of 2007.

Marketing and advertising expense increased from \$403,000 in 2007 to \$525,000 in 2008, which is attributed to the promotions surrounding MPB's 140<sup>th</sup> anniversary celebration as well as continuing promotion of loan and deposit products to enhance market share.

Occupancy and equipment expenses also increased in 2008 due to the recognition of a full year expenses for the new Camp Hill office and the relocated Elizabethville office, coupled with rising utility costs.

Legal and professional expenses increased in 2008 to \$694,000 from \$562,000 in 2007. MPB incurred increased legal fees associated with its loan workout efforts. The increase was also driven by ongoing projects within the technology and human resources area to enhance MPB's ability to attract and retain new customers and employees.

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

Another expense of note in 2008 was the increase in FDIC insurance premiums resulting from the ongoing financial crisis. In 2008, MPB's FDIC premium expense was \$116,000 compared with \$43,000 in 2007.

Severance expense related to the departure of the former CEO in October of 2008 was \$478,000. This reflects the contractual payments due under the terms of his employment contract with MPB.

The final significant item was the loss on sale or write-down on foreclosed assets of \$281,000 in 2008 as compared with minimal amounts in both 2007 and 2006. This item resulted from MPB's ongoing analysis of the carrying values of our repossessed properties and the adjustment of their values to current market rates in the face of the overall decline in real estate values plaguing the economy.

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis****TABLE 5: NONINTEREST EXPENSE**(Dollars in thousands)

	<b>Years ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Salaries and employee benefits	\$ 7,197	\$ 6,554	\$ 6,000
Severance expense	478		
Occupancy expense, net	967	868	622
Equipment expense	870	828	699
Pennsylvania bank shares tax expense	315	329	286
Legal and professional expense	694	562	560
Early withdrawal penalty on investment CDs			191
Marketing and advertising expense	525	403	255
ATM debit card processing expense	169	140	129
Director fees and benefits expense	354	322	250
Computer expense	457	434	378
Stationery and supplies expense	242	263	235
Postage expense	162	152	139
Meals, travel, and lodging expense	146	109	96
Contributions expense	134	97	60
Internet banking expense	112	88	59
Courier expense	112	107	92
Core deposit intangible expense	66	131	39
Service charge expense	90	88	76
FDIC insurance	116	43	41
Loss / write-down on sale of foreclosed assets	281		6
Other	1,239	1,078	1,050
<b>Total Noninterest Expense</b>	<b>\$ 14,726</b>	<b>\$ 12,596</b>	<b>\$ 11,263</b>

**Investments**

MPB's investment portfolio is utilized to provide liquidity and managed to maximize return within reasonable risk parameters.

MPB's entire portfolio of investment securities is considered available for sale. As such, the investments are recorded at fair value. Our investments: US Treasury, Agency and Municipal securities are valued at a market price relative to investments of the same type with similar maturity dates. As the interest rate environment of these securities changes, the value of securities changes accordingly.

As of December 31, 2008, SFAS No. 115 (the marking of securities to market value) resulted in an increase in shareholders' equity of \$553,000 (unrealized gain on securities of \$838,000 less estimated income tax expense of \$285,000). At December 31, 2007, SFAS No. 115 resulted in an increase in the unrealized gain included in other comprehensive income of \$434,000 (unrealized gain on securities of \$657,000 less estimated income tax expense of \$223,000) compared to a December 31, 2006 increase in the unrealized gain included in other comprehensive income of \$291,000 (unrealized gain on securities of \$441,000, less estimated income tax expense of \$150,000). MPB does not have any significant concentrations within investment securities.

Table 6 provides a history of the amortized cost of investment securities at December 31, for each of the past three years. The unrealized gains and losses on investment securities are shown in Note 6 to the Consolidated Financial Statements.



**Table of Contents**

MID PENN BANCORP, INC.

Management's Discussion and Analysis

**TABLE 6: AMORTIZED COST OF INVESTMENT SECURITIES**

(Dollars in thousands)

	December 31,		
	2008	2007	2006
U.S. Treasury and U.S. government agencies	\$ 22,347	\$ 12,044	\$ 15,015
Mortgage-backed U.S. government agencies	4,154	6,862	9,041
State and political subdivision obligations	25,151	30,437	29,050
Equity securities	250	250	250
<b>Total</b>	<b>\$ 51,902</b>	<b>\$ 49,593</b>	<b>\$ 53,356</b>

Maturity and yield information relating to the investment portfolio is shown in Table 7.

**TABLE 7: INVESTMENT MATURITY AND YIELD**

Amortized Cost

(Dollars in thousands)

	December 31, 2008				
	One Year and Less	After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	Total
U.S. Treasury and U.S. government agencies	\$ 11,503	\$ 4,602	\$ 6,242	\$	\$ 22,347
State and political subdivision obligations	140	4,450	11,865	8,696	25,151
Mortgage-backed U.S. government agencies		20	22	4,112	4,154
Equity securities				250	250
<b>Total</b>	<b>\$ 11,643</b>	<b>\$ 9,072</b>	<b>\$ 18,129</b>	<b>\$ 13,058</b>	<b>\$ 51,902</b>

	One Year and Less	After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	Total
<b><u>Weighted Average Yields</u></b>					
U.S. Treasury and U.S. government agencies	4.31%	4.33%	4.93%		4.49%
State and political subdivision obligations (FTE)	6.70%	7.10%	7.00%	6.40%	6.81%
Mortgage-backed U.S. government agencies		6.50%	4.17%	5.13%	5.13%
Equity securities				3.75%	3.75%
<b>Total</b>	<b>4.34%</b>	<b>5.69%</b>	<b>6.28%</b>	<b>5.95%</b>	<b>5.66%</b>

**Loans**

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

At December 31, 2008, loans and leases totaled \$434,643,000; a \$57,515,000 or 15.3% increase from December 31, 2007. During 2008, MPB experienced a net increase in commercial real estate and commercial/industrial loans of approximately \$43,534,000, the majority of which was generated in the greater Harrisburg (Capital) Region.

At December 31, 2008, loans, net of unearned income, represented 80.2% of earning assets as compared to 77.9% on December 31, 2007, and 76.1% on December 31, 2006.

The Bank's loan portfolio is diversified among individuals, farmers, and small and medium-sized businesses generally located within the Bank's trading area of Dauphin County, lower Northumberland County, western Schuylkill County and eastern Cumberland County. Commercial real estate, construction and land development loans are collateralized mainly by mortgages on the income-producing real estate or land involved. Commercial, industrial and agricultural loans are made to business entities and may be secured by business assets, including commercial real estate, or may be unsecured. Residential real estate loans are secured by liens on the residential property. Consumer loans include installment loans, lines of credit and home equity loans. The Bank has no concentration of credit to any one borrower or industry segment. The only concentration is in loans secured by commercial real estate.



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

A distribution of the Bank's loan portfolio according to major loan classification is shown in Table 8.

**TABLE 8: LOAN PORTFOLIO**

(Dollars in thousands)

	<b>2008</b>		<b>2007</b>		<b>December 31, 2006</b>		<b>2005</b>		<b>2004</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
Commercial real estate, construction and land development	\$ 234,762	53.9	\$ 197,192	52.1	\$ 191,420	63.0	\$ 183,543	58.6	\$ 163,145	58.0
Commercial, industrial and agricultural	71,385	16.4	65,421	17.3	60,566	16.8	39,820	12.7	28,211	10.0
Real estate - residential	118,547	27.2	106,141	28.0	98,323	27.3	80,530	25.7	77,662	27.6
Consumer	11,103	2.5	9,987	5.0	10,027	2.8	9,530	3.0	12,065	4.3
<b>Total Loans</b>	<b>435,797</b>	<b>100.0</b>	<b>378,741</b>	<b>100.0</b>	<b>360,336</b>	<b>100.0</b>	<b>313,423</b>	<b>100.0</b>	<b>281,083</b>	<b>100.0</b>
Unearned income	(1,154)		(1,613)		(1,763)		(1,586)		(1,536)	
Loans net of unearned discount	434,643		377,128		358,573		311,837		279,547	
Allowance for loan and lease losses	(5,505)		(4,790)		(4,187)		(3,704)		(3,643)	
<b>Net loans</b>	<b>\$ 429,138</b>		<b>\$ 372,338</b>		<b>\$ 354,386</b>		<b>\$ 308,133</b>		<b>\$ 275,904</b>	

MPB's maturity and rate sensitivity information related to the loan portfolio is reflected in Table 9.

**TABLE 9: LOAN MATURITY AND INTEREST SENSITIVITY**

(Dollars in thousands)

	<b>December 31, 2008</b>			
	<b>One Year and Less</b>	<b>After One Year thru Five Years</b>	<b>After Five Years</b>	<b>Total</b>
Commercial real estate, construction and land development	\$ 18,315	\$ 14,198	\$ 202,249	\$ 234,762
Commercial, industrial and agricultural	4,014	23,158	44,213	71,385
Real estate - residential mortgages	11,756	26,182	80,609	118,547
Consumer	1,899	4,817	3,233	9,949
<b>Total</b>	<b>\$ 35,984</b>	<b>\$ 68,355</b>	<b>\$ 330,304</b>	<b>\$ 434,643</b>
<b>Rate Sensitivity</b>				
Predetermined rate	\$ 22,305	\$ 53,227	\$ 42,813	\$ 118,345
Floating or adjustable rate	122,475	187,316	6,507	316,298
<b>Total</b>	<b>\$ 144,780</b>	<b>\$ 240,543</b>	<b>\$ 49,320</b>	<b>\$ 434,643</b>

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is maintained at a level believed adequate by Management to absorb potential losses in the loan and lease portfolio. MPB has a loan review department that is charged with establishing a watch list of potentially unsound loans, identifying unsound credit practices and suggesting corrective actions. A quarterly review and reporting process is in place for monitoring those loans that are on the watch list. Each credit on the watch list is evaluated to estimate potential losses. In addition, loss estimates for each category of

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

credit are provided based on Management's judgment, which considers past experience, current economic conditions and other factors. For installment, real estate mortgages and other consumer loans, specific reserve allocations are based on past loss experience adjusted for recent portfolio growth and economic trends.

Calculated amounts resulting from this analysis are specific allocations. The amounts not specifically provided for individual classes of loans are considered general. The general portion of the allowance is determined and based on judgments regarding economic lending conditions, management trends and other factors.

The 2008 provision of \$1,230,000 is an increase of \$305,000 over the \$925,000 provision in 2007. The larger provision is reflective of the robust growth in the loan portfolio during 2008 as well as the widening deterioration in economic conditions and the continuing decline of the real estate market.

The allocation of the allowance for loan and lease losses among the major classifications is shown in Table 10 as of December 31 of each of the past five years. The allowance for loan and lease losses at December 31, 2008 was \$5,505,000, or 1.27% of total loans less unearned discount as compared to \$4,790,000, or 1.27% at December 31, 2007 and \$4,187,000 or 1.17% at December 31, 2006.

**TABLE 10: ALLOCATION OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES**

(Dollars in thousands)

	December 31,				
	2008	2007	2006	2005	2004
Commercial real estate, construction and land development	\$ 3,326	\$ 2,908	\$ 2,462	\$ 2,037	\$ 2,368
Commercial, industrial and agricultural	1,860	1,607	1,515	1,481	1,093
Real estate - residential	87	75	54	52	65
Consumer	172	148	124	110	83
General	60	52	32	24	34
Total allowance for loan and lease losses	\$ 5,505	\$ 4,790	\$ 4,187	\$ 3,704	\$ 3,643

**Nonperforming Assets**

Nonperforming assets, other than consumer loans and 1-4 family residential mortgages, include impaired and nonaccrual loans, loans past due 90 days or more, restructured loans and other real estate (including residential property). Nonaccrual loans are loans on which we no longer recognize daily interest income. A loan is generally classified as nonaccrual when principal or interest has consistently been in default for a period of 90 days or more, or because of a deterioration in the financial condition of the borrower, payment in full of principal or interest is not expected. Loans past due 90 days or more and still accruing interest are loans that are generally well secured and in the process of collection or repayment. Restructured loans are those loans whose terms have been modified to lower interest or principal payments because of borrower financial difficulties. Foreclosed assets held for sale include those assets that have been acquired through foreclosure for debts previously contracted, in settlement of debt.

Consumer loans are generally recommended for charge-off when they become 90 days delinquent. All 1-4 family residential mortgages 90 days or more past due are reviewed quarterly by Management, and collection decisions are made in light of the analysis of each individual loan. The amount of consumer and residential mortgage loans past due 90 days or more at year-end was \$465,000, \$916,000 and \$586,000 in 2008, 2007 and 2006, respectively.

A presentation of nonperforming assets as of December 31 for each of the past five years is given in Table 11. At December 31, 2008, there were ten parcels of primarily residential real estate in Other Real Estate Owned. The foreclosed assets held for sale at December 31, 2007, consisted of three parcels of commercial real estate in Other Real Estate Owned and three lease repossession in Other Assets-Repossession Property.



**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis****TABLE 11: NONPERFORMING ASSETS**

(Dollars in thousands)

	December 31,				
	2008	2007	2006	2005	2004
Nonaccrual loans	\$ 4,113	\$ 4,317	\$ 1,293	\$ 1,773	\$ 873
Past due 90 days or more	1,860	2,439	995	1,086	397
Restructured loans	51				
Total nonperforming loans	6,024	6,756	2,288	2,859	1,270
Foreclosed assets held for sale	1,516	587	146	458	505
Total nonperforming assets	\$ 7,540	\$ 7,343	\$ 2,434	\$ 3,317	\$ 1,775
Percent of loans outstanding	1.73%	1.94%	0.68%	1.06%	0.63%
Percent of total assets	1.32%	1.44%	0.50%	0.76%	0.44%
There are no trends or uncertainties related to nonperforming assets, which Management expects will materially impact future operating results, liquidity or capital resources.					

**Deposits and Other Funding Sources**

MPB's primary source of funds is its deposits. Total deposits at December 31, 2008, increased by \$64,007,000 or 17.2% over December 31, 2007, which increased by \$8,591,000 or 2.4% over December 31, 2006. Average balances and average interest rates applicable to the major classifications of deposits for the years ended December 31, 2008, 2007, and 2006 are presented in Table 12.

Average short-term borrowings for 2008 were \$29,144,000 as compared to \$22,528,000 in 2007. These borrowings included customer repurchase agreements, treasury tax and loan option borrowings and federal funds purchased. A \$5,000,000 and a \$10,000,000 long-term borrowing matured in 2008, while one \$795,000 and three \$5,000,000 long-term borrowings were entered into during the year.

At December 31, 2008, the Bank had \$46,108,000 in brokered deposits. Due to our success in the local deposit environment, the Bank reduced its brokered deposit funding a net of \$3,649,000 in 2008 after having added \$10,000,000 in 2007.

**TABLE 12: DEPOSITS BY MAJOR CLASSIFICATION**

(Dollars in thousands)

	Years ended December 31,					
	2008		2007		2006	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing demand deposits	\$ 47,393	0.00%	\$ 44,021	0.00%	\$ 43,161	0.00%
Interest-bearing demand deposits	36,551	0.30%	35,048	0.41%	31,877	0.28%
Money market	69,251	2.10%	63,927	3.45%	60,968	3.11%
Savings	25,607	0.25%	25,513	0.28%	24,772	0.25%
Time	230,773	4.29%	203,671	4.42%	172,792	3.95%

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

Total	\$ 409,575	2.81%	\$ 372,180	3.07%	\$ 333,570	2.66%
-------	------------	-------	------------	-------	------------	-------

27

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

The maturity distribution of time deposits of \$100,000 or more is reflected in Table 13.

**TABLE 13: MATURITY OF TIME DEPOSITS \$100,000 OR MORE**

(Dollars in thousands)

	December 31,		
	2008	2007	2006
Three months or less	\$ 12,446	\$ 8,536	\$ 675
Over three months to twelve months	38,264	19,952	11,300
Over twelve months	22,682	15,453	22,010
Total	\$ 73,392	\$ 43,941	\$ 33,985

**Capital Resources**

Stockholders' equity, or capital, is evaluated in relation to total assets and the risk associated with those assets. The detailed computation of the Bank's regulatory capital ratios can be found in Note 17 of Item 8, Notes to Consolidated Financial Statements, on page 57. The greater the capital resources, the more likely a corporation is to meet its cash obligations and absorb unforeseen losses. Too much capital, however, indicates that not enough of the company's earnings have been paid to stockholders and the buildup makes it difficult for a company to offer a competitive return on the stockholders' capital going forward. For these reasons capital adequacy has been, and will continue to be, of paramount importance.

Capital growth is achieved by retaining more in earnings than is paid out to our stockholders. Stockholders' equity increased in 2008 by \$10,466,000 or 25.8%, in 2007 by \$1,359,000 or 3.5%, and by \$2,224,000 or 6.0% in 2006. Capital was positively impacted in 2008 by the addition of \$10,000,000 from the U.S. Treasury's Capital Purchase Program. The program was designed to provide well-capitalized, secure financial institutions with additional capital in order to increase the flow of credit into the economy. The program details are discussed in the following section.

MPB's normal dividend payout allows for quarterly cash returns to its stockholders and provides earnings retention at a level sufficient to finance future growth. The dividend payout ratio, which represents the percentage of annual net income returned to the stockholders in the form of cash dividends, was 77% for 2008 compared to 60% for 2007 and 55% for 2006.

In December of 2008, MPB retired its treasury stock.

**Capital Purchase Program Participation**

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

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

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

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

of shareholders called for that purpose. These preferred share directors would be elected annually and serve until all accrued and unpaid dividends on the preferred shares have been paid.

The preferred shares may be redeemed by MPB at the aggregate liquidation value plus any unpaid dividends after February 15, 2012. Prior to this date, the preferred shares may only be redeemed by the Company in an amount up to the cash proceeds (minimum \$2,500,000) from qualifying equity offerings of any Tier 1 perpetual preferred or common stock. Any redemption is subject to the consent of the Board of Governors of the Federal Reserve System. Until December 19, 2011, or such earlier time as all preferred shares have been redeemed by the Company or transferred by Treasury to third parties that are not affiliated with Treasury, the Company may not, without Treasury's consent, increase its dividend rate per share of common stock or, with certain limited exceptions, repurchase its common stock.

The warrant is immediately exercisable and has a 10-year term. The exercise price and number of shares subject to the warrant are both subject to anti-dilution adjustments. Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise



## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Management's Discussion and Analysis**

of the warrant; however, this agreement not to vote the shares does not apply to any person who may acquire such shares. If the Company receives aggregate gross proceeds of at least \$10,000,000 from one or more qualifying equity offerings of Tier 1-eligible perpetual preferred or common stock on or prior to December 31, 2009, the number of shares of common stock underlying the warrant then held by Treasury will be reduced by one half of the original number of shares underlying the warrant, after taking into account all adjustments.

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

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

#### **Emergency Economic Stabilization Act of 2008**

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

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

ii. Has a value in an amount that is not greater than one-third of the total amount of annual compensation of the employee receiving the stock; and

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

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

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

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

## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Management's Discussion and Analysis**

#### **Federal Income Taxes**

Federal income tax expense for 2008 was \$1,104,000 compared to \$1,394,000 and \$1,624,000 in 2007 and 2006, respectively. The effective tax rate was 24% for 2008, 23% for 2007 and 25% for 2006.

#### **Liquidity**

MPB's asset-liability management policy addresses the management of MPB's liquidity position and its ability to raise sufficient funds to meet deposit withdrawals, fund loan growth and meet other operational needs. MPB utilizes its investments as a source of liquidity, along with deposit growth and increases in repurchase agreements and borrowings. (See Deposits and Other Funding Sources which appears earlier in this discussion.) Liquidity from investments is provided primarily through investments and interest-bearing balances with maturities of one year or less. Funds are available to MPB through loans from the Federal Home Loan Bank and established federal funds (overnight) lines of credit. MPB's major source of funds is its core deposit base.

Major sources of cash in 2008 came from the net increase in deposits of \$64,007,000, as well as the proceeds from investment securities and long-term borrowings of \$18,420,000 and \$15,795,000, respectively. Another major source of funds were the proceeds from the U.S. Treasury's Capital Purchase Program of \$10,000,000.

The major use of cash in 2008 was a net increase in loans and leases of \$59,586,000. Other major uses of cash included the purchase of investment securities of \$20,515,000, the increase in interest-bearing balances of \$4,216,000, the payment of \$2,787,000 in cash dividends, and the purchase of bank premises and equipment of \$1,587,000.

Major sources of cash in 2007 came from operations and a net increase in deposits of \$8,591,000, as well as an increase in short-term borrowings of \$13,074,000. Another major source of funds were proceeds from the maturity of investment securities of \$10,074,000.

The major use of cash in 2007 was a net increase in loans and leases of \$19,385,000. Other major uses of cash included the purchase of investment securities of \$6,670,000, the payment of \$2,773,000 in cash dividends, and the purchase of bank premises and equipment of \$1,885,000.

#### **Effects of Inflation**

A bank's asset and liability structure is substantially different from that of an industrial company in that virtually all assets and liabilities of a bank are monetary in nature. Management believes the impact of inflation on its financial results depends principally upon MPB's ability to react to changes in interest rates and, by such reaction, mitigate the inflationary impact on performance. Interest rates do not necessarily move in the same direction or at the same magnitude as the prices of other goods and services. As discussed previously, Management seeks to manage the relationship between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

Information shown elsewhere in this Annual Report will assist in the understanding of how MPB is positioned to react to changing interest rates and inflationary trends. In particular, the summary of net liabilities, as well as the composition of loans, investments and deposits should be considered.

#### **Off-Balance Sheet Items**

MPB makes contractual commitments to extend credit and extends lines of credit, which are subject to MPB's credit approval and monitoring procedures.

As of December 31, 2008, commitments to extend credit amounted to \$98,034,000 as compared to \$88,148,000 as of December 31, 2007.

MPB also issues financial standby letters of credit to its customers. The risk associated with financial standby letters of credit is essentially the same as the credit risk involved in loan extensions to customers. Financial standby letters of credit decreased to \$10,517,000 at December 31, 2008, from \$11,480,000 at December 31, 2007.

Comprehensive Income

Comprehensive Income is a measure of all changes in equity of a corporation, excluding transactions with owners in their capacity as owners (such as proceeds from issuances of stock and dividends). The difference between Net Income and Comprehensive Income is termed Other Comprehensive Income. For MPB, Other Comprehensive Income consists primarily of unrealized gains and losses on available-for-sale securities, net of deferred income tax. Other Comprehensive Income also includes a pension component in accordance with FASB Statement No. 158. Comprehensive Income should not be construed to be a measure of Net Income. The effect of Other Comprehensive Income would only be reflected in the income statement if the entire portfolio of available-for-sale securities were sold on the statement date. The amount of unrealized gains or losses reflected in Comprehensive Income may vary widely at statement dates depending on the markets as a whole and how interest rate movements affect the market value of the portfolio of available-for-sale securities. Other Comprehensive Income (Loss) for the years ended December 31, 2008, 2007 and 2006 was \$404,000, (\$33,000) and \$86,000, respectively.

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis****ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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

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

Modeling techniques and simulation analysis involve assumptions and estimates that inherently cannot be measured with complete precision. Key assumptions in the analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturing deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of MPB's interest rate risk position over time.

Management reviews interest rate risk on a monthly basis. This analysis includes earnings scenarios whereby interest rates are increased and decreased by 100, 200, and 300 basis points. These scenarios, detailed in Table 14, indicate that there would not be a significant variance in net interest income over a one-year time frame due to interest rate changes; however, actual results could vary significantly from the calculations prepared by Management. At December 31, 2008, all interest rate risk levels according to the model were within the tolerance limits of Board approved policy. In addition, the table does not take into consideration changes, which Management would make to realign its portfolio in the event of a changing rate environment.

**TABLE 14: EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES**

December 31, 2008			December 31, 2007		
Change in	% Change in		Change in	% Change in	
Basis Points	Net Interest	Risk Limit	Basis Points	Net Interest	Risk Limit
300	-11.97%	+/- 25%	300	1.69%	+/- 25%
200	-7.89%	+/- 15%	200	1.10%	+/- 15%
100	-4.02%	+/- 10%	100	0.46%	+/- 10%
0			0		
(100)	3.99%	+/- 10%	(100)	-0.65%	+/- 10%
(200)	7.76%	+/- 15%	(200)	-1.35%	+/- 15%
(300)	11.69%	+/- 25%	(300)	-2.10%	+/- 25%

**Table of Contents**

**MID PENN BANCORP, INC.**

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The following audited financial statements are set forth in this Annual Report of Form 10-K on the following pages:

Index to Financial Statements and Supplementary Data

<u>Report of Independent Registered Public Accounting Firm</u>	33
<u>Consolidated Balance Sheets</u>	34
<u>Consolidated Statements of Income</u>	35
<u>Consolidated Statements of Changes in Stockholders' Equity</u>	36
<u>Consolidated Statements of Cash Flows</u>	37
<u>Notes to Consolidated Financial Statements</u>	39

---

**Table of Contents**

**MID PENN BANCORP, INC.**

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders

Mid Penn Bancorp, Inc.:

We have audited the accompanying consolidated balance sheets of Mid Penn Bancorp, Inc. and subsidiaries (collectively, the Corporation ) as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2008. The Corporation's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 2, 2009 expressed an unqualified opinion.

Williamsport, Pennsylvania  
March 2, 2009

**Table of Contents****MID PENN BANCORP, INC.**

(Dollars in thousands, except share data)

**Consolidated Balance Sheets**

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 7,478	\$ 10,599
Interest-bearing balances with other financial institutions	51,046	46,830
Available-for-sale investment securities	52,739	50,250
Loans and leases	434,643	377,128
Less: Allowance for loan and lease losses	(5,505)	(4,790)
<b>Net loans and leases</b>	<b>429,138</b>	<b>372,338</b>
Bank premises and equipment, net	11,377	10,638
Restricted investment in bank stocks	3,618	3,822
Foreclosed assets held for sale	1,516	529
Accrued interest receivable	2,747	2,818
Deferred income taxes	2,150	2,053
Goodwill	1,016	1,016
Core deposit and other intangibles, net	406	473
Cash surrender value of life insurance	7,437	6,961
Other assets	1,632	1,430
<b>Total Assets</b>	<b>\$ 572,300</b>	<b>\$ 509,757</b>
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>		
<b>Deposits:</b>		
Noninterest bearing demand	\$ 48,602	\$ 46,478
Interest bearing demand	39,048	36,627
Money Market	75,750	62,596
Savings	25,364	25,101
Time	248,060	202,015
<b>Total Deposits</b>	<b>436,824</b>	<b>372,817</b>
Short-term borrowings	23,977	37,349
Long-term debt	55,223	54,581
Accrued interest payable	2,411	1,990
Other liabilities	2,975	2,576
<b>Total Liabilities</b>	<b>521,410</b>	<b>469,313</b>
<b>Stockholders' Equity:</b>		
Preferred stock, par value \$1,000; authorized 10,000,000 shares; 5% cumulative dividend; 10,000 shares issued at December 31, 2008	10,000	
Common stock, par value \$1 per share; authorized 10,000,000 shares; 3,533,340 shares issued at December 31, 2008 and December 31, 2007, respectively	3,480	3,533
Warrants	70	
Additional paid-in capital	29,768	31,107
Retained earnings	7,168	6,660
Accumulated other comprehensive income (loss)	404	284
Treasury stock, at cost (0 and 43,706 shares at December 31, 2008 and December 31, 2007, respectively)		(1,140)
<b>Stockholders' Equity, Net</b>	<b>50,890</b>	<b>40,444</b>



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

Total Liabilities and Stockholders' Equity	\$ 572,300	\$ 509,757
--	------------	------------

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

**Table of Contents****MID PENN BANCORP, INC.**

(Dollars in thousands, except per share data)

**Consolidated Statemnets of Income**

	Years Ended December 31,		
	2008	2007	2006
<b>INTEREST INCOME</b>			
Interest & fees on loans and leases	\$ 27,141	\$ 26,357	\$ 23,455
Interest on interest-bearing balances	2,499	2,546	2,225
Interest and dividends on investment securities:			
U.S. Treasury and government agencies	819	944	1,032
State and political subdivision obligations, tax-exempt	1,251	1,361	1,287
Other securities	146	203	186
Interest on federal funds sold and securities purchased under agreements to resell		33	29
<b>Total Interest Income</b>	<b>31,856</b>	<b>31,444</b>	<b>28,214</b>
<b>INTEREST EXPENSE</b>			
Interest on deposits	11,532	11,430	8,868
Interest on short-term borrowings	608	1,049	686
Interest on long-term debt	2,750	2,860	3,178
<b>Total Interest Expense</b>	<b>14,890</b>	<b>15,339</b>	<b>12,732</b>
<b>Net Interest Income</b>	<b>16,966</b>	<b>16,105</b>	<b>15,482</b>
<b>PROVISION FOR LOAN AND LEASE LOSSES</b>	<b>1,230</b>	<b>925</b>	<b>735</b>
<b>Net Interest Income After Provision for Loan and Lease Losses</b>	<b>15,736</b>	<b>15,180</b>	<b>14,747</b>
<b>NONINTEREST INCOME</b>			
Trust department income	313	319	258
Service charges on deposits	1,654	1,499	1,376
Investment securities gains, net	9		33
Increase in cash surrender value of life insurance	267	271	219
Mortgage banking income	163	160	126
Other income	1,276	1,232	1,016
<b>Total Noninterest Income</b>	<b>3,682</b>	<b>3,481</b>	<b>3,028</b>
<b>NONINTEREST EXPENSE</b>			
Salaries and employee benefits	7,197	6,554	5,998
Severance expense	478		
Occupancy expense, net	967	868	622
Equipment expense	870	828	699
Pennsylvania Bank Shares tax expense	315	329	286
Legal and Professional fees	694	562	560
Director fees and benefits expense	354	322	250
Marketing and advertising expense	525	403	255
Computer expense	457	434	378
Stationery and supplies expense	242	263	235
Loss on sale / write-down of foreclosed assets	281		6
Other expenses	2,346	2,033	1,974
<b>Total Noninterest Expense</b>	<b>14,726</b>	<b>12,596</b>	<b>11,263</b>

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

INCOME BEFORE PROVISION FOR INCOME TAXES	4,692	6,065	6,512
Provision for income taxes	1,104	1,394	1,624
NET INCOME	\$ 3,588	\$ 4,671	\$ 4,888

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

**Table of Contents****MID PENN BANCORP, INC.  
FOR YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006****Consolidated Statements of Changes in Stockholders' Equity**

(Dollars in thousands, except share data)

	Common Stock	Preferred Stock	Warrants	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
<b>Balance, December 31, 2005</b>	\$ 3,208	\$ 0	\$ 0	\$ 23,472	\$ 10,486	\$ 231	\$ (536)	\$ 36,861
Comprehensive income:								
Net income					4,888			4,888
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects						60		60
Adjustment to initially apply FASB Statement No. 158, net of tax								
Net transition obligation						(58)		(58)
Net gain						84		84
Total comprehensive income								4,974
Cash dividends (\$.80 per share)					(2,652)			(2,652)
Stock dividend 5% issued February 2006	159			3,980	(4,139)			
Purchase of treasury stock (3,982 shares)							(98)	(98)
<b>Balance, December 31, 2006</b>	3,367			27,452	8,583	317	(634)	39,085
Comprehensive income:								
Net income					4,671			4,671
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects						143		143
Defined benefit plans, net of tax effects:								
Net prior service cost						(199)		(199)
Net gain						13		13
Net transition obligation						10		10
Total comprehensive income								4,638
Cash dividends (\$.80 per share)					(2,773)			(2,773)
Stock dividend 5% issued February 2007	166			3,655	(3,821)			
Purchase of treasury stock (20,668 shares)							(506)	(506)
<b>Balance, December 31, 2007</b>	3,533			31,107	6,660	284	(1,140)	40,444
Cumulative effect adjustment of accounting principle adoption of EITF No. 06-04					(277)			(277)
<b>Balance, January 1, 2008</b>	3,533			31,107	6,383	284	(1,140)	40,167
Comprehensive income:								

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

Net income					3,588				3,588
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects						120			120
Total comprehensive income									3,708
Cash dividends (\$.80 per share)					(2,787)				(2,787)
Issuance of preferred stock and warrants	10,000	70							10,070
Accrued preferred dividends					(16)				(16)
Purchase of treasury stock (9,854 shares)								(252)	(252)
Cancellation of treasury stock	(53)			(1,339)				1,392	
<b>Balance, December 31, 2008</b>	<b>\$ 3,480</b>	<b>\$ 10,000</b>	<b>\$ 70</b>	<b>\$ 29,768</b>	<b>\$ 7,168</b>	<b>\$ 404</b>	<b>\$ 0</b>	<b>\$ 50,890</b>	

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

**Table of Contents****MID PENN BANCORP, INC.**

(Dollars in thousands)

**Consolidated Statements of Cash Flows**

	Years Ended December 31,		
	2008	2007	2006
<b>Operating Activities:</b>			
Net Income	\$ 3,588	\$ 4,671	\$ 4,888
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses	1,230	925	735
Depreciation	848	809	638
(Accretion) amortization of core deposit intangible	66	66	39
(Increase) decrease in cash surrender value of life insurance	(476)	194	(219)
Investment securities gains, net	(9)		(33)
Loss on sale / write-down of foreclosed assets	281	9	(104)
Gain on sale of loans		(21)	
Gain on disposal of bank premises and equipment			(9)
Change in deferred income taxes	(158)	(427)	(262)
Change in accrued interest receivable	71	4	(464)
Change in other assets	(131)	(651)	(25)
Change in accrued interest payable	421	78	266
Change in other liabilities	106	(172)	241
<b>Net Cash Provided by Operating Activities</b>	<b>5,837</b>	<b>5,485</b>	<b>5,691</b>
<b>Investing Activities:</b>			
Net (increase) decrease in interest-bearing balances	(4,216)	91	7,628
Proceeds from the maturity of investment securities	18,420	10,074	5,546
Proceed from the sale of investment securities			1,923
Purchases of investment securities	(20,515)	(6,670)	(13,728)
Purchase of life insurance			(533)
Cash received from business combination			7,100
Net increase in loans and leases	(59,586)	(19,385)	(31,011)
Proceeds from sale of bank premises and equipment			13
Purchases of bank premises and equipment	(1,587)	(1,885)	(1,044)
Proceeds from sale of foreclosed assets	288	137	746
<b>Net Cash Used in Investing Activities</b>	<b>(67,196)</b>	<b>(17,638)</b>	<b>(23,360)</b>
<b>Financing Activities:</b>			
Net increase in demand deposits and savings accounts	17,962	8,433	723
Net increase (decrease) in time deposits	46,045	158	11,036
Net increase (decrease) in short-term borrowings	(13,372)	13,074	11,933
Issued senior preferred stock	10,000		
Cash dividend paid	(2,787)	(2,773)	(2,652)
Long-term debt repayment	(15,153)	(5,132)	(10,125)
Purchase of treasury stock	(252)	(506)	(98)
Proceeds from long-term borrowings	15,795		10,000
<b>Net Cash Provided by Financing Activities</b>	<b>58,238</b>	<b>13,254</b>	<b>20,817</b>
Net increase (decrease) in cash and due from banks	(3,121)	1,101	3,148
Cash and due from banks, beginning of period	10,599	9,498	6,350
<b>Cash and due from banks, end of period</b>	<b>\$ 7,478</b>	<b>\$ 10,599</b>	<b>\$ 9,498</b>



**Table of Contents****MID PENN BANCORP, INC.**

(Dollars in thousands)

**Consolidated Statements of Cash Flows**

	Years Ended December 31,		
	2008	2007	2006
<b>Supplemental Disclosures of Cash Flow Information:</b>			
Interest paid	\$ 14,469	\$ 15,261	\$ 12,355
Income taxes paid	\$ 1,720	\$ 1,930	\$ 1,910
<b>Supplemental Noncash Disclosures:</b>			
Loan chargeoffs	\$ 647	\$ 460	\$ 309
Transfers to foreclosed assets held for sale	\$ 1,556	\$ 529	\$ 330
Warrants issued	\$ 70	\$	\$
Cancelled treasury stock	\$ 1,392	\$	\$
Preferred dividend accrued	\$ 17	\$	\$

**Business Combination:**

(Dollars in thousands)

	2006
<b><u>Investing Activities:</u></b>	
Cash received from business combination	\$ 7,100
<b><u>Supplemental Noncash Disclosures:</u></b>	
<b>Noncash Assets Received and Liabilities Assumed from Acquisition of Branches</b>	
<b>Assets received:</b>	
Loans	\$ 16,307
Accrued interest receivable	89
Bank Premises and equipment	2,826
Intangible assets core deposit intangible	232
Intangible asset goodwill	757
Other assets	14
Total noncash assets received	\$ 20,225
<b>Liabilities assumed:</b>	
Deposits	\$ 27,193
Accrued interest payable	111
Other liabilities	21
Total noncash liabilities assumed	\$ 27,325

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



## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Notes to Consolidated Financial Statements**

#### **(1) Basis of Presentation**

The accompanying consolidated financial statements include the accounts of Mid Penn Bancorp, Inc. and its wholly-owned subsidiaries Mid Penn Bank ( "Bank" ), Mid Penn Investment Corporation and Mid Penn Insurance Services, LLC, (collectively, "MPB" ). All significant intercompany balances and transactions have been eliminated in consolidation.

#### **(2) Nature of Business**

The Bank engages in a full-service commercial banking and trust business, making available to the community a wide range of financial services, including, but not limited to, installment loans, mortgage and home equity loans, secured and unsecured commercial and consumer loans, lines of credit, construction financing, farm loans, community development loans, loans to non-profit entities and local government loans and various types of time and demand deposits, including but not limited to, checking accounts, savings accounts, clubs, money market deposit accounts, certificates of deposit and IRAs. In addition, the Bank provides a full range of trust services through its Trust Department. Deposits are insured by the Federal Deposit Insurance Corporation (FDIC) to the extent provided by law.

The financial services are provided to individuals, partnerships, non-profit organizations, and corporations through its fourteen offices located in Dauphin County, the southern portion of Northumberland County, the western portion of Schuylkill County and Hampden Township and the borough of Camp Hill in Cumberland County.

Mid Penn Insurance Services, LLC provides a range of personal and investment insurance products.

Mid Penn Investment Corporation is currently inactive.

#### **(3) Summary of Significant Accounting Policies**

The accounting and reporting policies of MPB conform with accounting principles generally accepted in the United States of America and to general practice within the financial industry. The following is a description of the more significant accounting policies.

##### **(a) Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan and lease losses.

While management uses available information to recognize losses on loans and leases, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan and lease losses. Such agencies may require the Bank to recognize changes to the allowance based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowance for loan and lease losses may change materially in the near term.

##### **(b) Investment Securities**

Available-for-Sale Securities includes debt and equity securities. Debt and equity securities are reported at fair value, with unrealized holding gains and losses excluded from earnings and reported, net of deferred income taxes, as a component of accumulated other comprehensive income (loss) within stockholders' equity. Realized gains and losses on sales of investment securities are computed on the basis of specific identification of the cost of each security. MPB had no trading securities or held-to-maturity securities in 2008 or 2007.

(c) **Loans**

Interest on loans is recognized on a method that approximates a level yield basis over the life of the loans. The accrual of interest on loans, including impaired loans, is generally discontinued when principal or interest has consistently been in default for a period of 90 days or more, or because of a deterioration in the financial condition of the borrower, payment in full of principal or interest is not expected. Interest income is subsequently recognized only to the extent cash payments are received. The placement of a loan on the nonaccrual basis for revenue recognition does not necessarily imply a potential charge-off of loan principal. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield on the related loan.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Notes to Consolidated Financial Statements**

#### **(d) Allowance for Loan and Lease Losses**

The Bank's methodology for determining the allowance for loan and lease losses establishes both a specific and a general component. The specific portion of the allowance represents the results of analysis of leases and individual watch list loans (commercial, residential and consumer loans). The individual commercial loans are risk rated with specific attention to estimated loss exposure. Historical loan loss rates are applied to problem consumer credits, adjusted to reflect current conditions.

Specific regular reviews of credits exceeding \$500,000 are performed to monitor the major portfolio risk. The Bank analyzes all commercial loans in excess of \$10,000 that are rated as watch list credits. Potential credit problems are monitored to determine whether specific loans are impaired, with impairment normally measured by reference to borrowers' collateral values and estimated cash flows.

The general portion of the allowance for loan and lease losses represents the results of measuring potential losses inherent in the portfolio that are not identified in the specific allowance analysis. This general portion is determined using historical loan and lease loss experience adjusted by assessing changes in the Bank's underwriting criteria, growth and/or changes in the mix of loans originated, industry concentrations and evaluations, lending management changes, comparisons of certain factors to peer group banks and changes in economic conditions.

Management believes the allowance for loan and lease losses is adequate. Identification of specific losses is an ongoing process using available information. Specifically, quarterly management meetings to review problem loans and leases are utilized to determine a plan for collection and, if necessary, a recommendation to the Board for charge off. Future additions to the allowance for loan and lease losses through a provision for loan and lease losses will be made based on identified changes in the above factors coupled with loss experience.

Various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan and lease losses. These agencies may require the Bank to recognize changes to the allowance based on their judgment about information available to them at the time of their examinations.

#### **(e) Bank Premises and Equipment**

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets. Maintenance and repairs are charged to expense when incurred, while major additions and improvements are capitalized. Gains and losses on disposals are reflected in current operations.

#### **(f) Foreclosed Assets Held for Sale**

Foreclosed assets held for sale consist primarily of real estate acquired through, or in lieu of, foreclosure in settlement of debt and are recorded at fair value at the date of transfer. Any valuation adjustments required at the date of transfer are charged to the allowance for loan losses. Subsequent to acquisition, foreclosed assets are carried at the lower of cost or fair value less costs of disposal, based upon periodic evaluations that consider changes in market conditions and development and disposal costs. Operating results from assets acquired in satisfaction of debt, including rental income less operating costs and gains or losses on the sale of, or the periodic evaluation of foreclosed assets, are recorded in noninterest expense.

#### **(g) Investment in Limited Partnership**

MPB invested as a limited partner in a partnership in September 2008 that provides low-income housing in Enola, Pennsylvania. The carrying value of MPB's investment in the limited partnership was \$556,320 at December 31, 2008 using the equity method. MPB's maximum exposure to loss is limited to the carrying value of its investment at year-end. The project was not completed at year-end therefore there were no low income housing tax credits available as of December 31, 2008. The partnership anticipates receiving \$76,324 annually in low-income housing tax credits once the project is complete.

(h) **Income Taxes**

Certain items of income and expense are recognized in different accounting periods for financial reporting purposes than for income tax purposes. Deferred income tax assets and liabilities are provided in recognition of these temporary differences at currently enacted income tax rates. As changes in tax laws or rates are enacted, deferred income tax assets and liabilities are adjusted through the provision for income taxes. MPB recognizes interest and/or penalties related to income tax matters in income tax expense.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Notes to Consolidated Financial Statements**

#### **(i) Core Deposit Intangible**

Core deposit intangible is a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. The core deposit intangible is being amortized over an 8-year life on a straight-line basis. The core deposit intangible is subject to impairment testing whenever events or changes in circumstances indicate its carrying amount may not be recoverable.

#### **(j) Goodwill**

Goodwill is the excess of the purchase price over the fair value of assets acquired in connection with 2004 and 2006 business acquisitions accounted for as purchases. Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, requires a two-step process for testing the impairment of goodwill on at least an annual basis. No impairment of goodwill was recognized in 2008, 2007 or 2006.

#### **(k) Bank Owned Life Insurance**

MPB is the owner and beneficiary of bank owned life insurance ( BOLI ) policies on former directors. The earnings from the BOLI policies are an asset that can be liquidated, if necessary, with associated tax costs. However, MPB intends to hold these policies and, accordingly, MPB has not provided deferred income taxes on the earnings from the increase in cash surrender value.

Effective March 31, 2008, MPB adopted Emerging Issues Task Force ( EITF ) No. 06-4, Accounting for Deferred compensation and Post Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. As a result, MPB is required to change its method of accounting for endorsement split-dollar life insurance. Under the new accounting method, MPB is required to recognize a liability and a related compensation cost for endorsement split-dollar life insurance arrangements that provide a benefit to retired employees. As permitted by EITF No. 06-4, MPB recognized adoption as the cumulative effect of a change in accounting principle, which resulted in a reduction in retained earnings of \$276,754. The amount represents the present value of the postretirement cost for the endorsement split-dollar life insurance policies.

#### **(l) Marketing and Advertising Costs**

Marketing and advertising costs are expensed as incurred and were \$525,000 in 2008, \$403,000 in 2007, and \$255,000 in 2006.

#### **(m) Postretirement Benefit Plans**

MPB has adopted Statement of Financial Accounting Standards No. 132 (revised 2003), Employers Disclosures about Postretirement Benefits ( Revised SFAS No. 132 ). Revised SFAS No. 132 requires additional disclosures about defined benefit pension plans and other postretirement defined benefit plans. It does not change the measurement or recognition of those plans.

#### **(n) Other Benefit Plan**

A funded contributory defined-contribution plan is maintained for substantially all employees. The cost of the MPB defined contribution plan is charged to current operating expenses and is funded annually.

#### **(o) Trust Assets and Income**

Assets held by the Bank in a fiduciary or agency capacity for customers of the Trust Department are not included in the consolidated financial statements since such items are not assets of the Bank. Trust income is recognized on the cash basis, which is not materially different than if it were reported on the accrual basis.

**(p) Earnings Per Share**

Earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during each of the years presented giving retroactive effect to stock dividends and stock splits. The following data show the amounts used in computing basic and diluted earnings per share. As shown in the table that follows, diluted earnings per share is computed using weighted average common shares outstanding, plus weighted average common shares available from the exercise of all dilutive stock warrants issued to the U.S. Treasury under the provisions of the Capital Purchase Program, based on the average share price of MPB's common stock during the period. Earnings per share has been restated to reflect the retroactive effect of a five percent stock dividend issued in the second quarter of 2007.

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

(Dollars in thousands, except per share data)

	<b>Net Income</b>	<b>Weighted- Average Common Shares</b>	<b>Earnings Per Share</b>
<b>2008</b>			
Earnings per share (basic)	\$ 3,588	3,483,097	\$ 1.03
Dilutive effect of potential common stock arising from stock warrants: Exercise of outstanding stock warrants issued to U.S. Treasury under the Capital Repurchase Program		56	
Earnings per share (diluted)	\$ 3,588	3,483,153	\$ 1.03
<b>2007</b>			
Earnings per share (basic)	\$ 4,671	3,497,806	\$ 1.34
Earnings per share (diluted)	\$ 4,671	3,497,806	\$ 1.34
<b>2006</b>			
Earnings per share (basic)	\$ 4,888	3,514,820	\$ 1.39
Earnings per share (diluted)	\$ 4,888	3,514,820	\$ 1.39

**(q) Statement of Cash Flows**

For purposes of cash flows, MPB considers cash and due from banks to be cash equivalents.

**(r) Reclassifications**

Certain prior year amounts have been reclassified to conform to the current year's classifications.

**(4) Comprehensive Income**

The components of other comprehensive income (loss) and related tax effects are as follows:

(Dollars in thousands)

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Change in unrealized holding gains (losses) on available for sale securities	\$ 191	\$ 217	\$ 123
Less reclassification adjustment for gains realized in income	(9)		(33)

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

Net unrealized (losses) gains	182	217	90
Defined benefit plans:			
Net prior service cost		(301)	
Net gain		20	128
Net transition obligation		15	(88)
		(266)	40
Other comprehensive income	182	(49)	130
Income tax benefit (expense)	(62)	16	(44)
Net	\$ 120	\$ (33)	\$ 86



**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****(5) Restrictions on Cash and Due from Bank Accounts**

The Bank is required to maintain reserve balances with the Federal Reserve Bank of Philadelphia. The amounts of those required reserve balances were \$182,000 at December 31, 2008, and \$533,000 at December 31, 2007.

**(6) Investment Securities**

At December 31, 2008 and 2007, amortized cost, fair value, and unrealized gains and losses on investment securities are as follows:

(Dollars in thousands)

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

(Dollars in thousands)

	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
December 31, 2007				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 12,044	\$ 31	\$ 12	\$ 12,063
Mortgage-backed U.S. government agencies	6,862	26	30	6,858
State and political subdivision obligations	30,437	719	68	31,088
Equity securities	250		9	241
	\$ 49,593	\$ 776	\$ 119	\$ 50,250

Estimated fair values of debt securities are based on quoted market prices, where applicable. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments, adjusted for differences between the quoted instruments and the instruments being valued.

Included in equity securities is an investment in Access Capital Strategies, an equity fund that invests in low to moderate income financing projects. This investment was purchased in 2004 to help fulfill the Bank's regulatory requirement of the Community Reinvestment Act and at December 31, 2007, and December 31, 2008, is reported at fair value.

Investment securities having a fair value of \$41,847,000 at December 31, 2008, and \$38,771,000 at December 31, 2007, were pledged to secure public deposits and other borrowings.

Gains from sales or calls of investment securities amounted to \$9,000 in 2008 and \$33,000 in 2006. The proceeds from sales of investment securities were \$1,923,000 in 2006. There were no sales of investment securities in 2008 or 2007.

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

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2008 and 2007.

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

(Dollars in thousands)

December 31, 2008

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

(Dollars in thousands)

December 31, 2007

	Less Than 12 Months Fair Value	Unrealized Losses	12 Months or More Fair Value	Unrealized Losses	Fair Value	Total Unrealized Losses
Available-for-sale securities:						
U.S. Treasury and U.S. government agencies	\$	\$	\$ 5,488	\$ 12	\$ 5,488	\$ 12
Mortgage-backed U.S. government agencies			3,827	30	3,827	30
State and political subdivision obligations	1,473	58	1,336	10	2,809	68
Equity securities			241	9	241	9
Total temporarily impaired available-for-sale securities	\$ 1,473	\$ 58	\$ 10,892	\$ 61	\$ 12,365	\$ 119

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis; and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the intent and ability of MPB to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

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

The following is a schedule of the maturity distribution of investment securities at amortized cost and fair value at December 31, 2008 and 2007:

(Dollars in thousands)

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

	December 31, 2008		December 31, 2007	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in 1 year or less	\$ 11,643	\$ 11,671	\$ 3,895	\$ 3,899
Due after 1 year but within 5 years	9,053	9,378	7,347	7,469
Due after 5 years but within 10 years	18,106	18,929	18,075	18,402
Due after 10 years	8,696	8,352	13,164	13,382
	47,498	48,330	42,481	43,152
Mortgage-backed securities (avg. life 1.6 years)	4,154	4,173	6,862	6,857
Equity securities	250	236	250	241
	\$ 51,902	\$ 52,739	\$ 49,593	\$ 50,250

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****(7) Loans**

A summary of loans at December 31, 2008 and 2007 is as follows:

(Dollars in thousands)

	2008	2007
Commercial real estate, construction and land development	\$ 234,762	\$ 197,192
Commercial, industrial and agricultural	71,385	65,421
Real estate residential	118,547	106,141
Consumer	9,949	8,374
	<b>\$ 434,643</b>	<b>\$ 377,128</b>

Net unamortized loan fees and costs of \$303,000 in 2008 and \$330,000 in 2007 were deducted from loans.

Loans and available credit to Bank executive officers, directors, and corporations in which such executive officers and directors have beneficial interests as stockholders, executive officers, or directors aggregated approximately \$4,317,000 at December 31, 2008, and \$6,304,000 at December 31, 2007. New loans extended were \$3,087,000 in 2008 and \$320,000 in 2007. Net payments on these loans equaled \$1,436,000 during 2008 and \$74,000 during 2007. These loans were made on substantially the same basis, including interest rates and collateral as those prevailing for comparable transactions with other borrowers at the same time.

**(8) Allowance for Loan and Lease Losses**

Changes in the allowance for loan and lease losses for the years 2008, 2007 and 2006 are summarized as follows:

(Dollars in thousands)

	2008	2007	2006
Balance, January 1	\$ 4,790	\$ 4,187	\$ 3,704
Provision for loan and lease losses	1,230	925	735
Loans and leases charged off	(647)	(460)	(309)
Recoveries on loans and leases charged off	132	138	57
Balance, December 31	<b>\$ 5,505</b>	<b>\$ 4,790</b>	<b>\$ 4,187</b>

The recorded investment in loans and leases that are considered impaired amounted to \$4,113,000 on December 31, 2008, and \$4,317,000 on December 31, 2007, and \$1,126,000 on December 31, 2006. By definition, impairment of a loan or lease is considered when, based on current information and events, it is probable that all amounts due will not be collected according to the contractual terms of the loan or lease agreement. The allowance for loan and lease losses related to loans and leases classified as impaired amounted to \$369,000 at December 31, 2008 and \$429,000 at December 31, 2007. All impaired loans and leases at the end of 2008 and 2007 had related allowances. The average balances of these loans and leases amounted to \$4,604,000, \$2,504,000 and \$1,739,000 for the years 2008, 2007 and 2006, respectively. The Bank applies payments on impaired loans on a principal first basis. Interest income is recognized on impaired loans and leases on a cash basis. The following is a summary of cash receipts on impaired loans and leases, and how they were applied in 2008, 2007, and 2006.

(Dollars in thousands)

	2008	2007	2006
Cash receipts applied to reduce principal balance	\$ 2,564	\$ 1,112	\$ 563
Cash receipts recognized as interest income	238	17	2
<b>Total cash receipts</b>	<b>\$ 2,802</b>	<b>\$ 1,129</b>	<b>\$ 565</b>

Loans and leases which were past due 90 days or more for which interest continued to be accrued amounted to \$1,860,000 at December 31, 2008 and \$2,439,000 at December 31, 2007. Total nonaccrual loans and leases amounted to \$4,113,000 at December 31, 2008 and \$4,317,000 at December 31, 2007. The Bank has no commitments to lend additional funds to borrowers with impaired or nonaccrual loans.

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****(9) Bank Premises and Equipment**

At December 31, 2008 and 2007, bank premises and equipment are as follows:

(Dollars in thousands)

	2008	2007
Land	\$ 2,984	\$ 2,946
Buildings	9,060	8,765
Furniture and fixtures	8,001	6,916
Leasehold improvements	133	133
Construction in progress	168	
	20,346	18,760
Less accumulated depreciation	(8,969)	(8,122)
	\$ 11,377	\$ 10,638

Depreciation expense was \$848,000 in 2008, \$809,000 in 2007 and \$638,000 in 2006.

**(10) Deposits**

At December 31, 2008 and 2007, time deposits in denominations of \$100,000 or more amounted to \$73,392,000 and \$43,941,000, respectively. Interest expense on such certificates of deposit amounted to \$2,870,000, \$2,142,000 and \$1,549,000 for the years ended December 31, 2008, 2007 and 2006, respectively. These larger time deposits at December 31, 2008, mature as follows:

(Dollars in thousands)

	At December 31,	
	2008	2007
Certificates of \$100,000 or more matured in 2008	\$	\$ 28,488
Certificates of \$100,000 or more maturing in 2009	50,710	3,227
Certificates of \$100,000 or more maturing in 2010	10,143	3,800
Certificates of \$100,000 or more maturing in 2011	8,666	7,042
Certificates of \$100,000 or more maturing in 2012	2,457	915
Certificates of \$100,000 or more maturing in 2013	763	
Certificates of \$100,000 or more maturing thereafter	653	469
Total Certificates of \$100,000 or more	\$ 73,392	\$ 43,941

Brokered deposits included in the deposit totals equaled \$46,108,000 at December 31, 2008 and \$49,757,000 at December 31, 2007. Deposits and other funds from related parties held by MPB at December 31, 2008 and 2007 amounted to \$5,765,000 and \$6,184,000, respectively.

**(11) Short-term Borrowings**

Short-term borrowings as of December 31, 2008 and 2007 consisted of:

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

(Dollars in thousands)

	2008	2007
Federal funds purchased	\$ 17,920	\$ 29,600
Repurchase agreements	5,041	7,156
Treasury, tax and loan notes	1,016	593
	\$ 23,977	\$ 37,349

The weighted average interest rate on total short-term borrowings outstanding was 2.09% at December 31, 2008, and 3.90% at December 31, 2007.

Federal funds purchased represent overnight funds. Securities sold under repurchase agreements generally mature between one day and one year. Treasury, tax and loan notes are open-ended interest bearing notes payable to the U.S. Treasury upon call. All tax deposits accepted by the Bank are placed in the Treasury note account. The Bank also has unused lines of credit with several banks amounting to \$12,425,000 at December 31, 2008.



**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****(12) Long-term Debt**

The Bank is a member of the Federal Home Loan Bank of Pittsburgh (FHLB) and through its membership, the Bank can access a number of credit products, which are utilized to provide various forms of liquidity. As of December 31, 2008 and 2007, the Bank had long-term debt in the amount of \$55,223,000 and \$54,581,000, respectively, consisting of:

(Dollars in thousands)

	<b>At December 31,</b>	
	<b>2008</b>	<b>2007</b>
Loans matured in 2008 with rates ranging from 3.08% to 3.80%	\$	\$ 15,000
Loans maturing in 2009 with rates ranging from 4.22% to 7.24%	17,000	17,000
Loans maturing in 2010 with rates ranging from 6.28% to 6.71%	10,000	10,000
Loans maturing in 2011 at a rate of 5.13%	5,000	5,000
Loans maturing in 2013 with rates ranging from 4.08% to 4.75%	14,279	3,500
Loans maturing in 2015 at a rate of 4.18%	5,000	
Loans maturing in 2026 at a rate of 4.80%	3,857	3,992
Loans maturing in 2027 at a rate of 6.71%	87	89
<b>Total Long-term Debt</b>	<b>\$ 55,223</b>	<b>\$ 54,581</b>

The aggregate amounts due on long-term debt subsequent to December 31, 2008 are \$17,166,000 (2009), \$10,174,000 (2010), \$5,182,000 (2011), \$191,000 (2012), \$14,365,000 (2013), and \$8,145,000 thereafter. \$1,684,000 of the Bank's investments and the bank's entire mortgage loan portfolio is pledged to secure FHLB borrowings.

**(13) Postretirement Benefit Plans**

MPB has an unfunded noncontributory defined benefit plan for directors. The plan provides defined benefits based on years of service.

MPB also has other postretirement benefit plans covering full-time employees. These health care and life insurance plans are noncontributory.

The significant aspects of each plan are as follows:

**(a) Health Insurance**

For full-time employees who retire after at least 20 years of service, MPB will pay premiums for major medical insurance (as provided to active employees) for a period ending on the earlier of the date the participant obtains other employment where major medical coverage is available or the date of the participant's death; however, in all cases payment of medical premiums by MPB will not exceed five years. If the retiree becomes eligible for Medicare within the five-year period beginning on his/her retirement date, the Bank may pay, at its discretion, premiums for 65 Special coverage or a similar supplemental coverage. After the five-year period has expired, all MPB paid benefits cease; however, the retiree may continue coverage through the Bank at his/her own expense. This plan was amended in 2008 to encompass those employees that had achieved ten years of full-time continuous service to MPB as of January 1, 2008. Employees hired after that date and those that had not achieved the service requirements are not eligible for the plan.

**(b) Life Insurance**

For full-time employees who retire after at least 20 years of service, MPB will provide term life insurance. The amount of coverage prior to age 65 will be three times the participant's annual salary at retirement or \$50,000, whichever is less. After age 65, the life insurance coverage amount

will decrease by 10% per year, subject to a minimum amount of \$2,000.

(c) **Directors Retirement Plan**

MPB has an unfunded defined benefit retirement plan for directors with benefits based on years of service. The adoption of this plan generated unrecognized prior service cost of \$274,000, which is being amortized based on the expected future years of service of active directors. The unamortized balance at December 31, 2008, was \$274,000.

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

The following tables provide a reconciliation of the changes in the plan's health and life insurance benefit obligations and fair value of plan assets for the years ended December 31, 2008 and 2007, and a statement of the funded status at December 31, 2008 and 2007:

(Dollars in thousands)

	December 31, 2008	2007
Change in benefit obligations:		
Benefit obligations, January 1	\$ 625	\$ 624
Service cost	26	41
Interest cost	34	31
Actuarial loss (gain)	9	(48)
Plan amendment	(77)	
Change in assumptions	12	
Benefit payments	(22)	(23)
Benefit obligations, December 31	\$ 607	\$ 625
Change in fair value of plan assets:		
Fair value of plan assets, January 1	\$	\$
Employer contributions	22	23
Benefit payments	(22)	(23)
Fair value of plan assets, December 31	\$	\$
Funded status at year end	\$ (607)	\$ (625)

The amount recognized in the consolidated balance sheet at December 31, 2008 and 2007, is as follows:

(Dollars in thousands)

	2008	2007
Accrued benefit liability	\$ (607)	\$ (625)

The amounts recognized in accumulated other comprehensive income consist of:

	December 31, 2008	2007
Net transition obligation, net of tax effects	\$	\$ 49
Net gain, net of tax effects	(89)	(89)
Prior service cost, net of tax effects	(4)	

The accumulated benefit obligation for health and life insurance plans was \$607,000 and \$625,000 at December 31, 2008 and 2007, respectively.

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

The estimated net actuarial gain that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost during 2009 are \$10,260 and (\$1,053).

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

The components of net periodic postretirement benefit cost for 2008, 2007 and 2006 are as follows:

(Dollars in thousands)

	2008	2007	2006
Service cost	\$ 26	\$ 41	\$ 39
Interest cost	34	31	30
Amortization of transition obligation	4	15	15
Amortization of prior service cost	(1)		
Amortization of net (gain)	(7)	(7)	(4)
Net periodic postretirement benefit cost	\$ 56	\$ 80	\$ 80

Assumptions used in the measurement of MPB's benefit obligations at December 31, 2008 and 2007 are as follows:

	2008	2007
Weighted-average assumptions:		
Discount rate	5.75%	6.00%
Rate of compensation increase	4.75%	5.00%

Assumptions used in the measurement of MPB's net periodic benefit cost for the years ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
Weighted-average assumptions:			
Discount rate	6.00%	5.75%	5.50%
Rate of compensation increase	5.00%	5.00%	5.00%

Assumed health care cost trend rates at December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
Health care cost trend rate assumed for next year	8.50%	9.00%	9.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.50%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2014	2011	2010

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

(Dollars in thousands)

	One-Percentage Point Increase	One-Percentage Point Decrease
Effect on total of service and interest cost	\$ 5,537	\$ 4,808
Effect on accumulated postretirement benefit obligation	58,930	51,503

MPB expects to contribute \$26,970 to its life and health benefit plans in 2009.

Estimated Future Benefit Payments:	
1/1/2009 to 12/31/2009	\$ 26,970
1/1/2010 to 12/31/2010	23,119
1/1/2011 to 12/31/2011	31,657
1/1/2012 to 12/31/2012	24,228
1/1/2013 to 12/31/2013	30,626
1/1/2014 to 12/31/2018	280,609

Benefit obligations were measured as of December 31, 2008, for the postretirement benefit plan.

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

The following tables provide a reconciliation of the changes in the directors' defined benefit plan's benefit obligations and fair value of plan assets for the years ended December 31, 2008 and 2007 and a statement of the status at December 31, 2008 and 2007. This plan is unfunded:

(Dollars in thousands)

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Change in benefit obligations:		
Benefit obligations, January 1	\$ 1,098	\$ 716
Service cost	24	26
Interest cost	60	60
Actuarial (gain) loss	(15)	27
Plan amendment	(60)	324
Change in assumptions	1	(6)
Benefit payments	(52)	(49)
<b>Benefit obligations, December 31</b>	<b>\$ 1,056</b>	<b>\$ 1,098</b>
Change in fair value of plan assets:		
Fair value of plan assets, January 1	\$	\$
Employer contributions	52	49
Benefit payments	(52)	(49)
<b>Fair value of plan assets, December 31</b>	<b>\$</b>	<b>\$</b>
<b>Funded status at year end</b>	<b>\$ (1,056)</b>	<b>\$ (1,098)</b>

Amounts recognized in the consolidated balance sheet at December 31, 2008 and 2007 are as follows:

(Dollars in thousands)

	<b>2008</b>	<b>2007</b>
Accrued benefit liability	\$ (1,056)	\$ (1,098)

Amounts recognized in accumulated other comprehensive income consist of:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Net prior service cost, net of tax effect	\$ 142	\$ 196
Net loss (gain), net of tax effect	2	11

The accumulated benefit obligation for the retirement plan was \$1,056,000 at December 31, 2008 and \$1,098,000 at December 31, 2007.

The estimated net actuarial gain and prior service costs that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost during 2009 are \$0 and \$21,525.





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

The components of net periodic retirement cost for 2008, 2007 and 2006 are as follows:

(Dollars in thousands)

	2008	2007	2006
Service cost	\$ 24	\$ 26	\$ 20
Interest cost	60	59	37
Amortization of prior-service cost	21	27	
Net periodic retirement cost	\$ 105	\$ 112	\$ 57

Assumptions used in the measurement of MPB's benefit obligations at December 31, 2008 and 2007 are as follows:

	2008	2007
Weighted-average assumptions:		
Discount rate	5.75%	6.00%
Change in consumer price index	3.25%	3.50%

Assumptions used in the measurement of MPB's net periodic benefit cost for the years ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
Weighted-average assumptions:			
Discount rate	6.00%	5.75%	5.50%
Change in consumer price index	3.50%	3.25%	3.25%

MPB expects to contribute \$66,543 to its retirement plan in 2009.

Estimated Future Benefit Payments:	
1/1/2009 to 12/31/2009	\$ 66,543
1/1/2010 to 12/31/2010	68,207
1/1/2011 to 12/31/2011	69,897
1/1/2012 to 12/31/2012	82,354
1/1/2013 to 12/31/2013	83,832
1/1/2014 to 12/31/2018	441,975

Plan benefit obligations were measured as of December 31, 2008 for the directors' defined benefit plan.

The Bank is the owner and beneficiary of insurance policies on the lives of certain officers and directors, which informally fund the retirement plan obligation. The aggregate cash surrender value of these policies was \$3,204,000 and \$2,882,000 at December 31, 2008 and 2007, respectively.

**(14) Other Benefit Plans**

**(a) Defined-Contribution Plan**

The Bank has a funded contributory defined-contribution plan covering substantially all employees. The Bank's contribution to the plan was \$181,000 for 2008, \$241,000 for 2007 and \$251,000 for 2006.

**(b) Deferred Compensation Plans**

The Bank has an executive deferred compensation plan, which allows an executive officer to defer bonus compensation for a specified period in order to provide future retirement income. At December 31, 2008 and 2007, the Bank had accrued a liability of approximately \$164,000 and \$146,000, respectively, for this plan.

The Bank also has a directors' deferred compensation plan, which allows directors to defer receipt of fees for a specified period in order to provide future retirement income. At December 31, 2008 and 2007, the Bank had accrued a liability of approximately \$365,000 and \$274,000, respectively, for this plan.

---

**Table of Contents**

**MID PENN BANCORP, INC.**

**Notes to Consolidated Financial Statements**

**(c) Salary Continuation Agreement**

The Bank maintains a Salary Continuation Agreement (Agreement) for a former executive officer. The Agreement provides the former executive officer with a fixed annual benefit. The benefit is payable beginning at age 65 for a period of 15 years. At December 31, 2008 and 2007, the Bank has accrued a liability of approximately \$145,000 and \$261,000, respectively, for the Agreement. The expense related to the Agreement was (\$116,000) for 2008, \$29,000 for 2007 and \$37,000 for 2006.

The Bank is the owner and beneficiary of an insurance policy on the life of the participating former executive officer, which informally funds the benefit obligation. The aggregate cash surrender value of this policy was approximately \$1,000,000 and \$964,000 at December 31, 2008 and 2007, respectively.

**(d) Employee Stock Ownership Plan**

MPB has an Employee Stock Ownership Plan (ESOP) covering substantially all employees. Contributions to the ESOP are made at the discretion of the Board of Directors. Total expense related to MPB's contribution to the ESOP for 2008, 2007 and 2006 was \$86,000, \$79,000 and \$94,000, respectively. The ESOP held 47,995 and 45,193 common shares of MPB stock as of December 31, 2008, and December 31, 2007, respectively, all of which were allocated to plan participants. Shares held by the ESOP are considered outstanding for purposes of calculating earnings per share. Dividends paid on shares held by the ESOP are charged to retained earnings.

**(e) Split Dollar Life Insurance Arrangements**

At December 31, 2008 and 2007, the Bank had Split Dollar Life Insurance arrangements with two former executives for which the aggregate collateral assignment and cash surrender values are approximately \$1,666,000 and \$1,608,000, respectively.

Effective January 1, 2008, MPB adopted Emerging Issues Task Force ( EITF ) No. 06-4, Accounting for Deferred compensation and Post Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. Under the new accounting method, MPB is required to recognize a liability and a related compensation cost for endorsement split-dollar life insurance arrangements that provide a benefit to retired employees. As permitted by EITF No. 06-4, MPB recognized adoption as the cumulative effect of a change in accounting principle, which resulted in a reduction in retained earnings of \$276,754. The amount represents the present value of the postretirement cost for the endorsement split-dollar life insurance policies.

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****(15) Federal Income Taxes**

The following temporary differences gave rise to the net deferred tax asset at December 31, 2008 and 2007:

(Dollars in thousands)

	2008	2007
Deferred tax assets:		
Allowance for loan and lease losses	\$ 1,758	\$ 1,475
Benefit plans	996	963
Nonaccrual interest	114	132
Core deposit intangible	4	47
Severance	150	
<b>Total</b>	<b>3,022</b>	<b>2,617</b>
Deferred tax liabilities:		
Depreciation	(263)	(116)
Loan fees	(82)	(134)
Bond accretion	(69)	(58)
Prepaid expenses	(73)	
Goodwill and intangibles	(100)	(33)
Unrealized gain on securities	(285)	(223)
<b>Total</b>	<b>(872)</b>	<b>(564)</b>
Deferred tax asset, net	\$ 2,150	\$ 2,053

The provision for income taxes consists of the following:

(Dollars in thousands)

	2008	2007	2006
Currently payable	\$ 1,264	\$ 1,821	\$ 1,886
Deferred	(160)	(427)	(262)
<b>Total provision for income taxes</b>	<b>\$ 1,104</b>	<b>\$ 1,394</b>	<b>\$ 1,624</b>

A reconciliation of income tax at the statutory rate to MPB's effective rate is as follows:

(Dollars in thousands)

	2008	2007	2006
Provision at the expected statutory rate	\$ 1,596	\$ 2,001	\$ 2,214
Effect of tax-exempt income	(571)	(601)	(643)
Nondeductible interest	68	81	66

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

Other items	11	(87)	(13)
Provision for income taxes	\$ 1,104	\$ 1,394	\$ 1,624

MPB has no unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods. MPB does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

No amounts for interest and penalties were recorded in the income statement for the year ended December 31, 2008 or 2007. There were no amounts accrued for interest and penalties at December 31, 2008 or 2007.

MPB and its subsidiaries are subject to U.S. federal income tax and income tax for the state of Pennsylvania. MPB is no longer subject to examination by taxing authorities for years before 2005. Tax years 2005 through 2007 remain open to examination.

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****(16) Core Deposit Intangible**

A summary of core deposit intangible is as follows at December 31, 2008.

(Dollars in thousands)

	2004 Acquisition	2006 Acquisition	Total
Gross carrying amount	\$ 291	\$ 232	\$ 523
Less accumulated amortization	(166)	(60)	(226)
Net carrying amount	\$ 125	\$ 172	\$ 297

The core deposit intangibles for the acquisitions are being amortized over the weighted average useful life of 8 years, with no estimated residual value.

Amortization expense amounted to \$66,000 in 2008 and \$66,000 in 2007.

The estimated amortization expense of intangible assets for each of the five succeeding fiscal years is \$65,000 per year.

**(17) Regulatory Matters**

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. The regulations require the Bank to meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital classification is also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier I capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier I and total capital (as defined) to risk-weighted assets (as defined). To be considered adequately capitalized (as defined) under the regulatory framework for prompt corrective action, the Bank must maintain minimum Tier I leverage, Tier I risk-based and total risk-based ratios as set forth in the table. The Bank's actual capital amounts and ratios are also presented in the table.

(Dollars in thousands)

	Capital Adequacy					
	Actual:		Minimum Capital Required:		To Be Well-Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2008:						
Tier 1 Capital (to Average Assets)	\$ 39,975	7.2%	\$ 22,146	4.0%	\$ 27,683	5.0%
Tier 1 Capital (to Risk Weighted Assets)	39,975	9.3%	17,278	4.0%	25,917	6.0%
Total Capital (to Risk Weighted Assets)	45,376	10.5%	34,556	8.0%	43,195	10.0%

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

As of December 31, 2007:

Tier 1 Capital (to Average Assets)	\$ 38,591	7.6%	\$ 20,115	4.0%	\$ 25,144	5.0%
Tier 1 Capital (to Risk Weighted Assets)	38,591	9.4%	16,303	4.0%	24,454	6.0%
Total Capital (to Risk Weighted Assets)	43,381	10.6%	32,605	8.0%	40,753	10.0%

As of December 31, 2008, the Bank's capital ratios are in excess of the minimum and well-capitalized guidelines and MPB's capital ratios are in excess of the Bank's capital ratios.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Notes to Consolidated Financial Statements**

#### **(18) Concentration of Risk and Off-Balance Sheet Risk**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and financial standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and financial standby letters of credit written is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for direct, funded loans.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Financial standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The term of these financial standby letters of credit is generally one year or less.

As of December 31, 2008, commitments to extend credit amounted to \$98,034,000 and financial standby letters of credit amounted to \$10,517,000.

Significant concentration of credit risk may occur when obligations of parties engaged in similar activities occur and accumulate in significant amounts.

In analyzing the Bank's exposure to significant concentration of credit risk, management set a parameter of 10% or more of the Bank's total net loans outstanding as the threshold in determining whether the obligations of the same or affiliated parties would be classified as significant concentration of credit risk. Concentrations by industry, product line, type of collateral, etc., are also considered. U.S. Treasury securities, obligations of U.S. government agencies and corporations, and any assets collateralized by the same were excluded.

As of December 31, 2008, commercial real estate financing was the only similar activity that met the requirements to be classified as a significant concentration of credit risk. However, there is a geographical concentration in that most of the Bank's business activity is with customers located in Central Pennsylvania, specifically within the Bank's trading area made up of Dauphin County, lower Northumberland County, western Schuylkill County and Hampden Township in Cumberland County.

The Bank's highest concentrations of credit are in the areas of apartment building financing and hotel/motel lodging financings. Outstanding credit to these sectors amounted to \$37,181,000 or 8.6% and \$31,607,000 or 7.3%, respectively, of loans and leases outstanding as of December 31, 2008.

#### **(19) Commitments and Contingencies**

##### **Operating Leases:**

In April 2005, MPB entered into a non-cancelable operating lease agreement to lease approximately 2,500 square feet of office space in the downtown Harrisburg area, with the initial term extending through April 2010. MPB has the option to renew this lease for two additional five-year periods. MPB also has a lease on its former Halifax office, closed in January of 2009, which currently runs through October of 2009.

Minimum future rental payments under these operating leases as of December 31, 2008, are as follows:



2009	\$ 89,051
2010	24,582
	\$ 113,633

**Table of Contents**

**MID PENN BANCORP, INC.**

**Notes to Consolidated Financial Statements**

**Litigation:**

MPB is subject to lawsuits and claims arising out of its business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated financial condition of MPB.

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****(20) Parent Company Statements**

The condensed balance sheets, statements of income and statements of cash flows for Mid Penn Bancorp, Inc., parent only, are presented below:

**CONDENSED BALANCE SHEETS**

(Dollars in thousands)

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>ASSETS</b>		
Cash	\$ 57	\$ 152
U.S. Treasury Investments	9,000	
Investment in Subsidiaries	41,779	40,292
Other Assets	70	
<b>Total Assets</b>	<b>\$ 50,906</b>	<b>\$ 40,444</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Other Liabilities	\$ 16	\$
Stockholders' Equity	50,890	41,584
Less: Treasury Stock		(1,140)
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 50,906</b>	<b>\$ 40,444</b>

**CONDENSED STATEMENTS OF INCOME**

(Dollars in thousands)

	<b>For Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Dividends from Subsidiaries	\$ 3,077	\$ 3,224	\$ 2,864
Other Income from Subsidiaries	84	37	61
Undistributed Earnings of Subsidiaries	628	1,517	2,134
Other Expenses	(201)	(107)	(171)
<b>Net Income</b>	<b>\$ 3,588</b>	<b>\$ 4,671</b>	<b>\$ 4,888</b>

**CONDENSED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

	<b>For Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net Income	\$ 3,588	\$ 4,671	\$ 4,888
Income from Subsidiaries	(644)	(1,517)	(2,134)

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

Net Cash Provided By Operating Activities	2,944	3,154	2,754
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Dividends Paid	(2,787)	(2,773)	(2,652)
Purchase of Treasury Stock	(252)	(506)	(98)
Net Cash Used in Financing Activities	(3,039)	(3,279)	(2,750)
Net (Decrease) Increase in Cash	(95)	(125)	4
Cash at Beginning of Period	152	277	273
Cash at End of Period	\$ 57	\$ 152	\$ 277

## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Notes to Consolidated Financial Statements**

#### **(21) Fair Value of Financial Instruments**

SFAS No. 107, Disclosures about Fair Value of Financial Instruments, requires disclosures of fair value information about financial instruments, whether or not recognized in the consolidated balance sheet, for which it is practical to estimate that value. In cases where quoted market values are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets, and in many cases, could not be realized in immediate settlement of the instrument. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of MPB.

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

Cash and due from banks:

The carrying value of cash and due from banks is considered to be a reasonable estimate of fair value.

Interest-bearing balances with other financial institutions:

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

Investment securities:

As indicated in Note 6, estimated fair values of investment securities are based on quoted market prices, where applicable. If quoted market prices are not available, fair values are based on quoted market prices for comparable instruments, adjusted for differences between the quoted instruments and the instruments being valued.

Loans:

The loan portfolio was segregated into pools of loans with similar economic characteristics and was further segregated into fixed rate and variable rate and each pool was treated as a single loan with the estimated fair value based on the discounted value of expected future cash flows. Fair value of loans with significant collectibility concerns (that is, problem loans and potential problem loans) was determined on an individual basis using an internal rating system and appraised values of each loan. Assumptions regarding problem loans are judgmentally determined using specific borrower information.

Deposits:

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

Short-term borrowings:

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

Long-term debt:

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

Accrued interest:

The carrying amount of accrued interest approximates their fair values.



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

The following table summarizes the book value and fair value of financial instruments at December 31, 2008 and 2007.

(Dollars in thousands)

	<b>December 31, 2008</b>		<b>December 31, 2007</b>	
	<b>Book Value</b>	<b>Fair Value</b>	<b>Book Value</b>	<b>Fair Value</b>
<b>Financial assets:</b>				
Cash and due from banks	\$ 7,478	\$ 7,478	\$ 10,599	\$ 10,599
Interest-bearing balances	51,046	51,046	46,830	46,830
Investment securities	52,739	52,739	50,250	50,250
Net loans	429,138	456,323	372,338	382,254
<b>Financial liabilities:</b>				
Deposits	\$ 436,824	\$ 447,482	\$ 372,817	\$ 377,919
Short-term borrowing	23,977	23,977	37,349	37,349
Accrued interest	2,411	2,411	1,990	1,990
Long-term debt	55,223	58,721	54,581	56,524
<b>Off-balance sheet financial instruments:</b>				
Commitments to extend credit	\$ 98,034	\$ 98,034	\$ 88,148	\$ 88,148
Financial standby letters of credit	10,517	10,517	11,480	11,480

**(22) Fair Value Measurement of Assets and Liabilities**

Effective January 1, 2008, Mid Penn adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements for financial assets and financial liabilities. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own belief about the assumptions market participants would use in pricing the asset or liability based upon the best information available in the circumstances. SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
Level 2 Inputs	Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability;
Level 3 Inputs	Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

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

*Securities Available for Sale*

Securities classified as available for sale are generally reported at fair value utilizing Level 2 inputs. For these securities, we obtain fair value measurements from an independent pricing service. These valuation services estimate fair value using pricing models and other accepted valuation methodologies, such as quotes for similar securities and observable yield curves and spreads. Level 3 inputs are used for investment security positions that are not traded in active markets or are subject to transfer restrictions. Such inputs are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.



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

Certain loans are evaluated for impairment using the practical expedients permitted by SFAS No. 114, Accounting by Creditors for Impairment of a Loan, including impaired loans measured at an observable market price (if available), or at the fair value of the loan's collateral (if the loan is collateral dependent). The value of the collateral is determined through appraisals performed by independent licensed appraisers. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Mid Penn considers the appraisals used in its impairment analysis to be Level 3 inputs. Impaired loans are reviewed and evaluated as needed for additional impairment, and reserves are adjusted accordingly.

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

(Dollars in thousands)

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

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

(Dollars in thousands)

	Total carrying value at December 31, 2008	Fair value measurements at December 31, 2008 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets:</b>				
Impaired Loans	\$ 4,113			\$ 4,113

Effective January 1, 2008, Mid Penn adopted the provisions of SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 expands the use of fair value accounting but does not affect existing standards, which require assets and liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, accounts payable, guarantees, issued debt and other eligible financial instruments. At December 31, 2008, Mid Penn had made no elections to use fair value as an alternative measurement for financial assets and liabilities not previously carried at fair value.

**(23) Common Stock**

MPB has reserved 50,000 of authorized, but unissued shares of its common stock for issuance under a Stock Bonus Plan (the Plan). Shares issued under the Plan are at the discretion of the board of directors.

Under MPB's amended and restated dividend reinvestment plan, (DRIP), 200,000 of MPB's authorized but unissued common stock are reserved for issuance. The DRIP also allows for voluntary cash payments within specified limits, for the purchase of additional shares.

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

In September of 2005, Mid Penn Bancorp's Board of Directors approved a Stock Repurchase Program under which the Corporation could buy back up to 250,000 shares of Mid Penn Bancorp Common Stock. Through December 31, 2008, 34,504 shares had been repurchased at an average price of \$24.75 per share. MPB retired all treasury stock in December of 2008 and the Stock Repurchase Program was terminated on December 10, 2008.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Notes to Consolidated Financial Statements**

#### **(24) Preferred Stock**

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

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

The Series A Preferred Stock will pay cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. The Series A Preferred Stock may not be redeemed during the first three years after issuance except from the proceeds from a Qualified Equity Offering and in accordance to the terms of the Letter Agreement. Thereafter, the Company may elect to redeem the Series A Preferred Stock at the original purchase price plus accrued but unpaid dividends, if any. The related Warrants expire in ten years and is immediately exercisable upon its issuance.

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

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

#### *Restrictions on Dividends*

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

#### *Repurchases*

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

#### *Voting Rights*

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

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements****(25) Summary of Quarterly Consolidated Financial Data (Unaudited)**

The following table presents summarized quarterly financial data for 2008, 2007 and 2006.

(Dollars in thousands, except per share data)

	2008 Quarter Ended			
	March 31	June 30	September 30	December 31
Interest Income	\$ 8,077	\$ 7,786	\$ 7,986	\$ 8,007
Interest Expense	3,877	3,639	3,694	3,680
Net Interest Income	4,200	4,147	4,292	4,327
Provision for Loan and Lease Losses	100	155	275	700
Net Interest Income After Provision for Loan Losses	4,100	3,992	4,017	3,627
Other Income	896	906	990	881
Securities Gains			8	1
Gain on Sale of Loans				
Other Expenses	3,446	3,478	3,525	4,277
Income Before Income Tax Provision	1,550	1,420	1,490	232
Income Tax Provision	377	360	368	(1)
Net Income	\$ 1,173	\$ 1,060	\$ 1,122	\$ 233
Earnings Per Share	\$ 0.34	\$ 0.30	\$ 0.32	\$ 0.07

(Dollars in thousands, except per share data)

	2007 Quarter Ended			
	March 31	June 30	September 30	December 31
Interest Income	\$ 7,705	\$ 7,780	\$ 7,950	\$ 8,010
Interest Expense	3,727	3,766	3,892	3,954
Net Interest Income	3,978	4,014	4,058	4,056
Provision for Loan and Lease Losses	75	125	175	550
Net Interest Income After Provision for Loan Losses	3,903	3,889	3,883	3,506
Other Income	837	836	749	1,029
Securities Gains				
Gain on Sale of Loans		21		
Other Expenses	3,291	3,190	3,050	3,057
Income Before Income Tax Provision	1,449	1,556	1,582	1,478
Income Tax Provision	365	377	372	280
Net Income	\$ 1,084	\$ 1,179	\$ 1,210	\$ 1,198
Earnings Per Share	\$ 0.32	\$ 0.34	\$ 0.35	\$ 0.33

**(26) Recent Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141(R) Business Combinations ( SFAS 141(R) ). SFAS 141(R) establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. SFAS 141(R) also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance will become effective as of the beginning of a company's fiscal year beginning after December 15, 2008. SFAS 141(R) will impact MPB's accounting for business combinations beginning January 1, 2009.

In December 2007, the FASB issued SFAS No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 ( SFAS 160 ). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a

## **Table of Contents**

### **MID PENN BANCORP, INC.**

### **Notes to Consolidated Financial Statements**

subsidiary and for the deconsolidation of a subsidiary. The guidance will become effective as of the beginning of a company's fiscal year beginning after December 15, 2008. Management does not believe that SFAS 160 will have a material impact on its consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. This FSP addresses the issue of whether or not these transactions should be viewed as two separate transactions or as one linked transaction. The FSP includes a rebuttable presumption that presumes linkage of the two transactions unless the presumption can be overcome by meeting certain criteria. The FSP will be effective for fiscal years beginning after November 15, 2008, and will apply only to original transfers made after that date; early adoption will not be allowed. Management does not believe that (FSP) FAS 140-3 will have a material impact on its consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (Statement 161). Statement 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. Statement 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 have been applied, and the impact that hedges have on an entity's financial position, financial performance, and cash flows. Statement 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Management does not believe that Statement 161 will have a material impact on its consolidated financial statements.

In September 2008, the FASB issued FASB Staff Position (FSP) FAS 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161 (FSP FAS 133-1/FIN 45-4). Financial services companies, who sell credit derivatives, will be required to provide expanded disclosures under FSP FAS 133-1/FIN 45-4. This FSP amends Statement 133 and FIN 45 to improve disclosures about credit derivatives by requiring more information about the potential adverse effects of changes in credit risk on the financial position, financial performance, and cash flows of the sellers of credit derivatives. The disclosures are required for all credit derivatives, whether freestanding or embedded in hybrid instruments. This FSP does not apply to purchasers of credit derivatives. The FSP is effective for reporting periods (annual or interim) ending after November 15, 2008. Management does not believe that FSP FAS 133-1/FIN 45-4 will have a material impact on its consolidated financial statements.

In December 2008, the FASB issued FASB Staff Position (FSP) FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets (FSP FAS 132(R)-1). FSP FAS 132(R)-1 amends FASB Statement No. 132 (revised 2003), Employer's Disclosures about Pensions and Other Postretirement Benefits (Statement 132(R)), to require additional disclosures about assets held in an employer's defined benefit pension or other postretirement plan. The disclosure requirements are intended to improve employer's disclosures about postretirement benefit plan assets and replaces the requirement to disclose the percentage of the fair value of total plan assets with a requirement to disclose the fair value of each major asset category. FSP FAS 132(R)-1 is effective for fiscal years ending after December 15, 2009, with early application of the provisions permitted. Upon initial application, the information required by the FSP is not required for earlier periods that are presented for comparative purposes. Management is currently evaluating the potential impact the new pronouncement will have on MPB's consolidated financial statements.

In January 2009, the FASB issued FASB Staff Position (FSP) EITF 99-20-1, Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20 (FSP EITF 99-20-1). FSP EITF 99-20-1 amends the impairment (and related interest income measurement) guidance for certain beneficial interests in securitized financial assets that are within the scope of EITF Issue No. 99-20, Recognition of Interest Income and Impairment of Purchased Beneficial Interests and Beneficial Interests that Continue to be Held by a Transferor in Securitized Financial Assets. The FSP eliminates the requirement that a holder's best estimate of cash flows be based upon those that a market participant would use. Instead, the FSP requires that an other-than-temporary impairment be recognized as a realized loss through earnings when it is probable there has been an adverse change in the holder's estimated cash flows from the cash flows previously projected, which is consistent with the impairment model in Statement 115. The FSP is effective for interim and annual reporting periods ending after December 15, 2008, and must be applied prospectively at the balance sheet date of the reporting period for which the assessment is made (e.g., December 31, 2008, for a calendar year-end entity). Management is currently evaluating the potential impact the new pronouncement will have on MPB's consolidated financial statements.



## **Table of Contents**

### **MID PENN BANCORP, INC.**

#### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

#### **ITEM 9A. CONTROLS AND PROCEDURES** **Evaluation of Disclosure Controls and Procedures**

MPB carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of December 31, 2008. Based upon that evaluation, the Interim Chief Executive Officer and Chief Financial Officer concluded that, MPB's disclosure controls and procedures are effective in timely alerting them to material information relating to MPB (including its consolidated subsidiaries) required to be included in periodic SEC filings.

#### **Changes in Internal Controls Over Financial Reporting**

There have been no material changes in MPB's internal control over financial reporting during the fourth quarter of 2008 that have materially affected, or are reasonably likely to materially affect, MPB's internal control over financial reporting.

#### **Mid Penn Bancorp, Inc. Management Report on Internal Controls Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a and 15(d) 15(f) under the Exchange Act of 1934 ( "1934 Act" ). The corporation's internal control over financial reporting includes those policies and procedures that pertain to the corporation's ability to record, process, summarize, and report reliable financial data. All internal control systems have inherent limitations in the effectiveness of any internal control over financial reporting, including the possibility of human error and the circumvention or overriding of internal control. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation and presentation. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

In order to ensure that the corporation's internal control over financial reporting is effective, management regularly assesses such controls and did so most recently for its financial reporting as of December 31, 2008. This assessment was based on criteria for effective internal control over financial reporting described in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management has concluded that MPB's internal control over financial reporting, as of December 31, 2008, is effective based on the criteria set forth by COSO in *Internal Control - Integrated Framework* .

Parente Randolph, LLC, independent registered public accounting firm that audited MPB's financial statements, has issued an audit report on the effectiveness of the corporation's internal control over financial reporting as of December 31, 2008.

Edwin D. Schlegel  
Interim President and  
Chief Executive Officer

Kevin W. Laudenslager  
Executive Vice President and  
Chief Financial Officer



**Table of Contents**

**MID PENN BANCORP, INC.**

**REPORT OF INDEPENDENT REGISTERED  
PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

Mid Penn Bancorp, Inc.:

We have audited Mid Penn Bancorp, Inc. and Subsidiaries (collectively, the Corporation) internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Mid Penn Bancorp, Inc. Management Report on Internal Controls Over Financial Reporting. Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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.

In our opinion, Mid Penn Bancorp, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets and related consolidated statements of income, changes in stockholders' equity, and cash flows of Mid Penn Bancorp, Inc. and Subsidiaries and our report dated March 2, 2009 expressed an unqualified opinion.

Williamsport, Pennsylvania

March 2, 2009

**ITEM 9B. OTHER INFORMATION**

None.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

## **PART III**

### **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item, relating to directors, executive officers, and control persons is set forth under the captions Executive Officers, Information Regarding Director Nominees and Continuing Directors, Compliance with Section 16(a) Reporting, Audit Committee Report, and Governance of the Corporation in MPB's definitive proxy statement to be used in connection with the 2009 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

The Company has adopted a Code of Ethics that applies to directors, officers and employees of the Company and the Bank. The Company amended the Code of Ethics twice in 2005 and a copy of the Code of Ethics is included as Exhibit 14 to the Form 8-K filed with the Securities and Exchange Commission on March 9, 2005. A request for the Company's Code of Ethics can be made in writing to Kevin W. Laudenslager, 349 Union Street, Millersburg, PA 17061, by telephone at 717-692-2133, or through the MPB website at [www.midpennbank.com](http://www.midpennbank.com).

### **ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item, relating to executive compensation, is set forth under the captions Compensation Discussion and Analysis, Executive Compensation, Potential Payments Upon Termination or Change In Control, Election of Directors, Compensation Committee Report and Compensation Committee Interlocks and Insider Participation of MPB's definitive proxy statement to be used in connection with the 2009 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item, relating to beneficial ownership of MPB's common stock, is set forth under the caption Beneficial Ownership of Mid Penn Bancorp's Stock Held By Principal Shareholders and Management of MPB's definitive proxy statement to be used in connection with the 2009 Annual Meeting of Shareholders, which pages are incorporated herein by reference. MPB does not maintain any equity compensation plans.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item, relating to transactions with management and others, certain business relationships and indebtedness of management, is set forth under the captions Certain Relationships and Related Transactions and Governance of the Corporation of MPB's definitive proxy statement to be used in connection with the 2009 Annual Meeting of Shareholders, which page is incorporated herein by reference.

### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this Item, relating to the fees and services provided by MPB's principal accountant, is set forth under the caption Audit Committee Report of MPB's definitive proxy statement to be used in connection with the 2009 Annual Meeting of Shareholders, which page is incorporated herein by reference.

## **PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

1. Financial statements are incorporated by reference in Part II, Item 8 hereof.  
Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Income

Consolidated Statements of Cash Flows

Consolidated Statements of Stockholders' Equity

Notes to Consolidated Financial Statements

2. The financial statement schedules, required by Regulation S-X, are omitted because the information is either not applicable or is included elsewhere in the consolidated financial statements.

## **Table of Contents**

### **MID PENN BANCORP, INC.**

3. The following Exhibits are filed as part of this filing on Form 10-K, or incorporated by reference hereto:

- 3(i) The Registrant's Articles of Incorporation. (Incorporated by reference to Exhibit 3.1 of Registrant's Registration Statement on Form S-3 (Registration No. 333-156759).
- 3(ii) Statement with Respect to Shares for Series A Preferred Stock. (Incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 22, 2008)
- 3(iii) The Registrant's By-laws. (Incorporated by reference to Exhibit 3(ii) of Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 10, 2008)
- 4.1 Warrants for Purchase of Shares of Common Stock. (Incorporated by reference to Exhibit 4.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 22, 2008)
- 10.1 Mid Penn Bank's Retirement Plan. (Incorporated by reference to Exhibit 10.1 of Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 10, 2008)
- 10.2 Mid Penn Bank's Employee Stock Ownership Plan. (Incorporated by reference to Exhibit 10.2 of Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 10, 2008)
- 10.3 The Registrant's Dividend Reinvestment Plan, as amended and restated. (Incorporated by reference to Registrant's Registration Statement on Form S-3, filed with the SEC on October 12, 2005)
- 10.4 Split Dollar Agreement between Mid Penn Bank and Eugene F. Shaffer. (Incorporated by reference to Registrant's Annual Report on Form 10-K filed with the SEC on March 14, 2005.)
- 10.5 Death Benefit Plan and Agreement between Mid Penn Bank and the Trustee of the Eugene F. Shaffer Irrevocable Trust. (Incorporated by reference to Registrant's Annual Report on Form 10-K filed with the SEC on March 14, 2005.)
- 10.6 Severance Agreement dated as of November 26, 2008 between Mid Penn Bank and Alan W. Dakey. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 1, 2008)
- 10.7 Letter Agreement, dated as of December 19, 2008, Between Mid Penn Bancorp, Inc. and the United States Department of the Treasury, which includes the Securities Purchase Agreement Standard Terms attached thereto, with respect to the issuance and sale of the Series A Preferred Stock and the Warrants. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 22, 2008)
- 11 Statement re: Computation of Per Share Earnings. (Incorporated by reference to Part II, Item 8 of this Annual Report on Form 10-K.)
- 12 Statements re: Computation of Ratios. (Incorporated by reference to Part II, Item 8 of this Annual Report on Form 10-K.)
- 14 The Registrant's Code of Ethics. (Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on March 9, 2005)
- 21 Subsidiaries of Registrant.
- 23 Consent of Parente Randolph, LLC, independent auditors.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.
- 32.1 Chief Executive Officer's §1350 Certification.

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

- 32.2 Chief Financial Officer's §1350 Certification.
- 99.1 Listing of Mid-Atlantic Custom Peer Group Banks.

**Table of Contents**

**MID PENN BANCORP, INC.**

**SIGNATURES**

Pursuant to the requirements of Section 12 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.

By: /s/ Edwin D. Schlegel  
Edwin D. Schlegel  
Chairman of the Board, Interim President and  
Chief Executive Officer  
(Principal Executive Officer)

Date: February 25, 2009

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

By: /s/ Edwin D. Schlegel  
Edwin D. Schlegel  
Interim President, Chief Executive Officer and  
  
Director  
(Principal executive officer)

February 25, 2009

By: /s/ Kevin W. Laudenslager  
Kevin W. Laudenslager  
Treasurer (Principal Financial and Principal Accounting  
Officer)

February 25, 2009

By: /s/ Jere M. Coxon  
Jere M. Coxon, Director

February 25, 2009

By: /s/ Matthew G. DeSoto  
Matthew G. DeSoto, Director

February 25, 2009

By: /s/ A. James Durica  
A. James Durica, Director

February 25, 2009

By: /s/ Robert C. Grubic  
Robert C. Grubic, Director

February 25, 2009

By: /s/ Gregory M. Kerwin  
Gregory M. Kerwin, Director

February 25, 2009

By: /s/ Theodore W. Mowery  
Theodore W. Mowery, Director

February 25, 2009

By: /s/ Donald E. Sauve  
Donald E. Sauve, Director

February 25, 2009

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

By: /s/ William A. Specht, III  
William A. Specht, Director

February 25, 2009



## **Table of Contents**

### **MID PENN BANCORP, INC.**

#### **EXHIBIT INDEX**

- 3(i) The Registrant's Articles of Incorporation. (Incorporated by reference to Exhibit 3.1 of Registrant's Registration Statement on Form S-3 (Registration No. 333-156759).
- 3(ii) Statement with Respect to Shares for Series A Preferred Stock. (Incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 22, 2008)
- 3(iii) The Registrant's By-laws. (Incorporated by reference to Exhibit 3(ii) of Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 10, 2008)
- 4.1 Warrants for Purchase of Shares of Common Stock. (Incorporated by reference to Exhibit 4.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 22, 2008)
- 10.1 Mid Penn Bank's Retirement Plan. (Incorporated by reference to Exhibit 10.1 of Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 10, 2008)
- 10.3 Mid Penn Bank's Employee Stock Ownership Plan. (Incorporated by reference to Exhibit 10.2 of Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 10, 2008)
- 10.3 The Registrant's Dividend Reinvestment Plan, as amended and restated. (Incorporated by reference to Registrant's Registration Statement on Form S-3, filed with the SEC on October 12, 2005)
- 10.6 Split Dollar Agreement between Mid Penn Bank and Eugene F. Shaffer. (Incorporated by reference to Registrant's Annual Report on Form 10-K filed with the SEC on March 14, 2005.)
- 10.7 Death Benefit Plan and Agreement between Mid Penn Bank and the Trustee of the Eugene F. Shaffer Irrevocable Trust.  
(Incorporated by reference to Registrant's Annual Report on Form 10-K filed with the SEC on March 14, 2005.)
- 10.6 Severance Agreement dated as of November 26, 2008 between Mid Penn Bank and Alan W. Dakey. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 1, 2008)
- 10.7 Letter Agreement, dated as of December 19, 2008, Between Mid Penn Bancorp, Inc. and the United States Department of the Treasury, which includes the Securities Purchase Agreement Standard Terms attached thereto, with respect to the issuance and sale of the Series A Preferred Stock and the Warrants. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K as filed with the Securities and Exchange Commission on December 22, 2008)
- 11 Statement re: Computation of Per Share Earnings. (Incorporated by reference to Part II, Item 8 of this Annual Report on Form 10-K.)
- 12 Statements re: Computation of Ratios. (Incorporated by reference to Part II, Item 8 of this Annual Report on Form 10-K.)
- 15 The Registrant's Code of Ethics. (Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on March 9, 2005)
- 21 Subsidiaries of Registrant.
- 23 Consent of Parente Randolph, LLC, independent auditors.

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

- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.
- 32.1 Chief Executive Officer s §1350 Certification.
- 32.2 Chief Financial Officer s §1350 Certification.
- 99.1 Listing of Mid-Atlantic Custom Peer Group Banks.