Benton Financial Corporation

Annual Report 2009

Benton Financial Corporation

December 31, 2009 and 2008

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Report to Stockholders

Over the years the pictures that have appeared on our front cover have more often than not been selected to impart some particular message. This year's picture is simply to provide tranquility and to inspire.

2009 was analogous to the after shocks of an earthquake, or the subsequent tidal waves of a tsunami. The financial melt down of 2008, of course, was the genesis of the fiscal calamities that resulted.

We are pleased to report, however, that 2009's earnings results exceeded that of 2008 by 10%. Per share earnings were $1.23 compared to $1.06 for 2008, while return on average equity capital increased from 5.45% to 5.93%. While many institutions slashed or eliminated cash dividends, ours were again increased, providing payment of $.68 per share.

It should be noted that 2009's net income of $947,266 was enhanced by recognizing uncertainties in the bond market, which allowed for securities' gains to be taken while simultaneously providing the ability to restructure the portfolio for future years.

Through several writings over the years, we have expressed our real and growing concern regarding the negative impact of legislative and regulatory initiatives. Our concerns have never been greater than now. We have also previously alerted you that community banks would be forced to pay for the "sins of our big brothers." By way of illustration, examine our FDIC insurance assessments - funds paid to insure the safety of depositors' accounts. In 2008 we paid $12,482, while in 2009 we were forced to pay $184,720, plus a prepaid five year assessment of $499,664. That is real money. However, the heavier cost ultimately will be the increased burden of still more regulations, a cost hard to really quantify.

Will Rogers once said, "Things in our country run in spite of government, not by aid of it." Whatever the challenge, we intend to remain steadfast in our goals of protecting shareholder value, providing meaningful dividends, and serving our communities and our customer base.

Sincerely,

Kenneth W. Deckard, Chairman
Steven T. Pettet, President & CEO

Financial Highlights

	2009	2008
PER SHARE		
Basic earnings	**$1.23**	$1.06
Cash dividends	**.68**	.675
Book value	**20.73**	19.51
PERFORMANCE RATIOS		
Return on average equity capital	**5.93%**	5.45%
Return on average assets	**.72%**	.67%
EARNINGS		
Net interest income	**$5,066,906**	$5,214,354
Provision for loan losses	**1,420,000**	724,000
Net income	**947,266**	860,435
Cash dividends	**520,949**	531,133
BALANCE SHEET AVERAGES		
Total assets	**$131,820,001**	$129,260,922
Loans (net)	**66,396,119**	66,353,257
Noninterest bearing balances	**10,944,864**	10,488,769
Interest bearing balances	**78,860,910**	77,448,911
Total deposits	**89,805,774**	87,937,680
Equity capital (net of unrealized gains)	**15,979,260**	15,775,132

Five Year Record

	Net Income		Dividend		Capital	
Year	Amount	Basic Earnings Per Share(1)(3)	Amount	Per Share(3)	Amount	Per Share(2)(3)
2005	$1,233,559	$1.43	$560,624	$0.65	$15,742,084	$ 18.31
2006	$ 976,089	$1.15	$546,904	$0.65	$15,798,276	$ 18.81
2007	$ 983,772	$1.18	$540,552	$0.65	$16,138,701	$ 19.41
2008	$ 860,435	$1.06	$531,133	$0.675	$15,091,006	$ 19.51
2009	$ 947,266	$1.23	$520,949	$0.68	$15,825,158	$ 20.73

(1) Based on average shares outstanding.
(2) Based on year-end outstanding shares.
(3) Adjusted for the 2 for 1 stock split.

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Independent Accountants' Report

To the Stockholders and
Board of Directors
Benton Financial Corporation
Fowler, Indiana

We have audited the accompanying consolidated balance sheets of Benton Financial Corporation as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 Benton Financial Corporation as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, in 2009, the Company changed its method of accounting for other-than-temporary impairment of debt securities through retrospective application of 2009 beginning balances.

BKD, LLP

Indianapolis, Indiana
March 15, 2010

Benton Financial Corporation

Consolidated Balance Sheets
December 31, 2009 and 2008

Assets

	2009	2008
Cash and due from banks	$ 5,425,641	$ 2,274,335
Interest-bearing demand deposits	208,997	267,275
Federal funds sold	-	2,320,000
Cash and cash equivalents	5,634,638	4,861,610
Interest-bearing time deposits	500,000	-
Trading assets	2,328,962	-
Investment securities available for sale	49,892,212	53,710,496
Loans, net of allowance for loan losses of $1,153,544 and $1,088,277 at December 31, 2009 and 2008, respectively	65,793,148	65,709,787
Premises and equipment	655,202	729,522
Federal Home Loan Bank stock	1,449,700	1,449,700
Interest receivable	1,465,913	1,471,984
Other assets	1,522,507	861,608
Total assets	$ 129,242,282	$ 128,794,707

Liabilities and Stockholders' Equity

Liabilities		
Deposits		
Noninterest-bearing	$ 11,820,222	$ 9,702,784
Interest-bearing	74,945,974	78,301,028
Total deposits	86,766,196	88,003,812
Borrowings	26,200,000	24,000,000
Interest payable	144,471	218,584
Other liabilities	306,457	1,481,305
Total liabilities	113,417,124	113,703,701
Stockholders' Equity		
Preferred stock, no par value		
Authorized and unissued - 250,000 shares		
Common stock, no par value		
Authorized - 1,200,000 shares		
Issued and outstanding - 763,455 and 773,455 shares	1,968,661	2,002,302
Capital surplus	1,203,834	1,224,401
Retained earnings	12,244,009	11,669,039
Accumulated other comprehensive income	408,654	195,264
Total stockholders' equity	15,825,158	15,091,006
Total liabilities and stockholders' equity	$ 129,242,282	$ 128,794,707

See Notes to Consolidated Financial Statements

Benton Financial Corporation

Consolidated Statements of Income
Years Ended December 31, 2009 and 2008

	2009	2008
Interest Income		
Loans receivable	$ 4,483,529	$ 5,029,110
Investment securities		
Taxable	2,047,933	2,142,109
Tax exempt	583,169	566,111
Deposits with financial institutions	9,343	85,661
Total interest income	7,123,974	7,822,991
Interest Expense		
Deposits	983,645	1,541,150
Long-term debt	1,073,423	1,067,487
Total interest expense	2,057,068	2,608,637
Net Interest Income	5,066,906	5,214,354
Provision for loan losses	1,420,000	724,000
Net Interest Income After Provision for Loan Losses	3,646,906	4,490,354
Other Income		
Fiduciary activities	112,783	113,129
Service charges on deposit accounts	423,620	499,760
Net realized gains on sales of available-for-sale securities	855,173	167,223
Other income	101,232	125,771
Total other income	1,492,808	905,883
Other Expenses		
Salaries and employee benefits	2,047,846	2,072,970
Net occupancy expense	147,038	154,732
Equipment expense	204,566	215,807
Data processing fees	249,271	301,649
Loss on impairment of available-for-sale securities	-	594,076
Other expenses	1,232,865	958,297
Total other expense	3,881,586	4,297,531
Income Before Income Tax	1,258,128	1,098,706
Income tax expense	310,862	238,271
Net Income	$ 947,266	$ 860,435
Earnings Per Share	$ 1.23	$ 1.06
Weighted-Average Shares Outstanding	770,934	810,208

See Notes to Consolidated Financial Statements

Benton Financial Corporation

Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2009 and 2008

	Common Stock				Accumulated Other Comprehensive	
	Shares Outstanding	Amount	Capital Surplus	Retained Earnings	Income (Loss)	Total
Balance, January 1, 2008	831,618	$ 2,194,328	$ 1,187,916	$ 12,707,781	$ 48,676	$ 16,138,701
Comprehensive income						
Net income				860,435		860,435
Change in unrealized losses on securities, net of reclassification adjustment and tax					146,588	146,588
Comprehensive income						1,007,023
Cash dividends ($0.675 per share)				(531,133)		(531,133)
Issuance of stock	7,153	30,472	156,936			187,408
Purchase of stock	(65,316)	(222,498)	(120,451)	(1,368,044)		(1,710,993)
Balance, December 31, 2008, as previously reported	773,455	2,002,302	1,224,401	11,669,039	195,264	15,091,006
Adjustment to reflect adoption of FASB ASC 320-10 (FSP SFAS 115-2)				356,445	(356,445)	-
Balance, January 1, 2009, following adoption of FASB ASC 320-10	773,455	2,002,302	1,224,401	12,025,484	(161,181)	15,091,006
Comprehensive income						
Net income				947,266		947,266
Change in unrealized losses on securities, net of reclassification adjustment and tax					569,835	569,835
Comprehensive income						1,517,101
Cash dividends ($0.68 per share)				(520,949)		(520,949)
Purchase of stock	(10,000)	(33,641)	(20,567)	(207,792)		(262,000)
Balance, December 31, 2009	763,455	$ 1,968,661	$ 1,203,834	$ 12,244,009	$ 408,654	$ 15,825,158

See Notes to Consolidated Financial Statements

Benton Financial Corporation

Consolidated Statements of Cash Flows
Years Ended December 31, 2009 and 2008

	2009	2008
Operating Activities		
Net income	$ 947,266	$ 860,435
Items not requiring (providing) cash		
Provision for loan losses	1,420,000	724,000
Depreciation and amortization	91,797	109,998
Deferred income taxes	(46,539)	(172,000)
Investment securities amortization, net	106,454	42,870
Investment securities gains	(855,173)	(167,223)
Impairment loss on available-for-sale investments	-	594,076
Net change in		
Trading assets	(2,328,962)	-
Interest receivable	6,071	9,330
Interest payable	(74,113)	(61,981)
Other assets	(991,955)	78,757
Other liabilities	(1,174,848)	(18,025)
Net cash provided by (used in) operating activities	(2,900,002)	2,000,237
Investing Activities		
Purchases of securities available for sale	(38,275,226)	(39,866,008)
Proceeds from maturities of securities available for sale	19,292,528	4,037,429
Proceeds from sales of securities available for sale	24,497,131	22,644,826
Net change in loans	(1,503,361)	1,854,227
Net change in interest-bearing time deposits	(500,000)	-
Purchase of premises and equipment	(17,477)	(103,833)
Net cash provided by (used in) investing activities	3,493,595	(11,433,359)
Financing Activities		
Net change in		
Noninterest-bearing, interest-bearing demand and savings deposits	1,672,350	5,983,263
Certificates of deposit	(2,909,966)	(1,741,602)
Repayment of FHLB advances	(3,500,000)	(4,000,000)
Proceeds from FHLB advances	5,700,000	7,000,000
Change in short-term borrowings	-	(1,395,000)
Cash dividends	(520,949)	(531,133)
Proceeds from issuance of stock	-	187,408
Purchase of stock	(262,000)	(1,710,993)
Net cash provided by financing activities	179,435	3,791,943
Net Change in Cash and Cash Equivalents	773,028	(5,641,179)
Cash and Cash Equivalents, Beginning of Year	4,861,610	10,502,789
Cash and Cash Equivalents, End of Year	$ 5,634,638	$ 4,861,610
Additional Cash Flows Information		
Interest paid	$ 2,131,181	$ 2,670,618
Income tax paid	731,471	81,819
Investment purchased in 2008 but not settled until 2009	-	985,419

See Notes to Consolidated Financial Statements

Benton Financial Corporation

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(Table Dollar Amounts in Thousands)

Note 1: Nature of Operations and Summary of Significant Accounting Policies

The accounting and reporting policies of Benton Financial Corporation (Company) and its wholly owned subsidiary, Fowler State Bank (Bank), conform to accounting principles generally accepted in the United States of America and reporting practices followed by the banking industry. The more significant of the policies are described below.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Company is a bank holding company whose principal activity is the ownership and management of the Bank. The Bank operates under a state bank charter and provides full banking services, including trust services. As a state bank, the Bank is subject to regulation by the Department of Financial Institutions, State of Indiana and the Federal Deposit Insurance Corporation.

The Bank generates commercial, mortgage and consumer loans and receives deposits from customers located primarily in Benton, Newton and Warren Counties, Indiana and surrounding counties. The Bank's loans are generally secured by specific items of collateral including real property, consumer assets and business assets. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon economic conditions in the agricultural industry.

Consolidation

The consolidated financial statements include the accounts of the Company and Bank after elimination of all material intercompany transactions.

Cash Equivalents

The Company considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2009, the Company did not have any cash equivalents. At December 31, 2008, cash equivalents consisted primarily of federal funds sold.

Effective October 3, 2008, the FDIC's insurance limits increased to $250,000. The increase in federally insured limits is currently set to expire December 31, 2013. At December 31, 2009, the Company's cash accounts were approximately $3,757,000 at the Federal Reserve Bank and the Federal Home Loan Bank - Indianapolis, which are not federally insured.

Trading Activities

Trading activities are engaged in by the Bank for its own account. Securities that are held principally for resale in the near term are recorded in the trading assets account at fair value with changes in fair value recorded in earnings. Interest is included in net interest income.

Investment Securities

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Effective April 1, 2009, the Company adopted new accounting guidance related to recognition and presentation of other-than-temporary impairment (ASC 320-10). When the Company does not intend to sell a debt security, and it is more likely than not, the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

For available-for-sale and held-to-maturity debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections.

Prior to the adoption of the recent accounting guidance on April 1, 2009, management considered, in determining whether other-than-temporary impairment exists, (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 the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Generally, loans are placed on non-accrual status at 90 days past due and interest is considered a loss, unless the loan is well-secured and in the process of collection.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent.

Premises and Equipment

Premises and equipment are carried at cost net of accumulated depreciation. Depreciation is computed using the straight-line method for premises and the declining balance method for equipment based principally on the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Federal Home Loan Bank Stock

Federal Home Loan Bank stock is a required investment for institutions that are members of the Federal Home Loan Bank system. The required investment in the common stock is based on a predetermined formula.

Income Tax

The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to the management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Company files consolidated income tax returns with its subsidiaries.

Earnings Per Share

Earnings per share have been computed based upon the weighted-average common shares outstanding during each year.

Current Economic Conditions

The current protracted economic decline continues to present financial institutions with difficult circumstances and challenges, which in some cases have resulted in large and unanticipated declines in the fair values of investments and other assets, constraints on liquidity and capital and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans.

At December 31, 2009, the Company held $10,594,000 in loans secured by commercial real estate. Due to national, state and local economic conditions, values for commercial and development real estate have declined significantly, and the market for these properties is depressed.

At December 31, 2009, the Company held $3,702,000 in agricultural production loans and $16,153,000 in agricultural real estate loans in the Company's local area.

The accompanying consolidated financial statements have been prepared using values and information currently available to the Company.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the consolidated financial statements could change rapidly, resulting in material future adjustments in asset values, the allowance for loan losses and capital that could negatively impact the Company's ability to meet regulatory capital requirements and maintain sufficient liquidity.

Note 2: Change in Accounting Principle (Changes in Other-Than-Temporary Impairment)

Effective January 1, 2009, the Company adopted FASB Staff Position FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (the FSP), which was subsequently incorporated in the FASB Codification in Topic 320-10. The FSP establishes a methodology of determining and recording other-than-temporary impairments (OTTI) of debt securities. This guidance now requires recognition of only the credit portion of the OTTI in current earning for those debt securities where there is not an intent to sell and it is not more likely than not that the entity would be required to sell the security prior to expected recovery. As permitted, the FSP has been applied retrospectively as of the beginning of 2009, which resulted in a reclassification of previously recognized OTTI of $356,445 to increase retained earnings and decrease accumulated other comprehensive income.

	Balance Sheet 2009		
	As Originally Reported	As Adjusted	Effect of Change
Retained earnings	$ 11,669	$ 12,025	$ 356
Accumulated other comprehensive income (loss)	195	(161)	(356)

Note 3: Restriction on Cash and Due From Banks

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The reserve required at December 31, 2009 was $161,000.

Note 4: Trading Assets

Trading assets, at fair value, consist of the following:

	2009	2008
Trading assets		
State and municipal	$ 2,329	$ -

The net unrealized losses on trading activities are as follows:

	2009	2008
State and municipal	$ 19	$ -

Note 5: Investment Securities

The amortized cost and approximate fair values of securities are as follows:

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
Available for sale				
Federal agencies	$ 8,142	$ 69	$ (58)	$ 8,153
State and municipal	29,280	670	(352)	29,598
Corporate	989	1	(62)	928
Mortgage-backed securities	10,805	409	(1)	11,213
Total available for sale	$ 49,216	$ 1,149	$ (473)	$ 49,892

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
Available for sale				
Federal agencies	$ 11,025	$ 119	$ (1)	$ 11,143
State and municipal	24,386	606	(651)	24,341
Corporate	632	-	(16)	616
Mortgage-backed securities	17,345	348	(83)	17,610
Total available for sale	$ 53,388	$ 1,073	$ (751)	$ 53,710

The amortized cost and fair value of securities available for sale at December 31, 2009, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Within one year	$ 6,661	$ 6,721
One to five years	10,903	10,955
Five to ten years	14,707	15,028
After ten years	6,140	5,975
	38,411	38,679
Mortgage-backed securities	10,805	11,213
Totals	$ 49,216	$ 49,892

Securities with a carrying value of $18,454,000 and $24,405,000 were pledged at December 31, 2009 and 2008 to secure certain deposits and for other purposes as permitted or required by law.

Proceeds from sales of securities available for sale during 2009 and 2008 were $24,497,000 and $22,645,000. Gross gains of $896,000 and $192,000 and gross losses of $41,000 and $25,000 were realized on those sales.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2009 and 2008 was $16,985,000 and $14,940,000, which is approximately 34% and 28% of the Company's available-for-sale investment portfolio. These declines primarily resulted from changes in market interest rates.

Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

Securities with unrealized losses at December 31, 2009 were as follows:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities						
Federal agencies	$ 5,284	$ (58)	$ -	$ -	$ 5,284	$ (58)
State and municipal	9,456	(249)	1,727	(103)	11,183	(352)
Corporate	-	-	178	(62)	178	(62)
Mortgage-backed securities	340	(1)	-	-	340	(1)
	$ 15,080	$ (308)	$ 1,905	$ (165)	$ 16,985	$ (473)

Securities with unrealized losses at December 31, 2008 were as follows:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities						
Federal agencies	$ 999	$ (1)	$ -	$ -	$ 999	$ (1)
State and municipal	9,753	(485)	1,264	(166)	11,017	(651)
Corporate	234	(16)	-	-	234	(16)
Mortgage-backed securities	1,798	(39)	892	(44)	2,690	(83)
	$ 12,784	$ (541)	$ 2,156	$ (210)	$ 14,940	$ (751)

State and Municipal

The unrealized losses on the Company's investments in securities of state and municipals were caused by interest rate changes. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2009.

Note 6: Loans and Allowance

	2009	2008
Commercial and industrial loans	$ 9,040	$ 8,515
Real estate loans (includes $16,153 and $15,915 secured by farmland)	46,870	48,191
Construction loans	108	274
Agricultural production financing and other loans to farmers	3,702	2,808
Individuals' loans for household and other personal expenditures	5,921	5,539
Other loans	1,306	1,471
	66,947	66,798
Allowance for loan losses	(1,154)	(1,088)
Total loans	$ 65,793	$ 65,710

	2009	2008
Allowance for loan losses		
Balances, January 1	$ 1,088	$ 932
Provision for losses	1,420	724
Recoveries on loans	43	184
Loans charged off	(1,397)	(752)
Balances, December 31	$ 1,154	$ 1,088

Impaired loans totaled $1,152,000 and $2,741,000 at December 31, 2009 and 2008, respectively. An allowance for loan losses of $28,000 and $117,000 relates to impaired loans of $32,000 and $293,000 at December 31, 2009 and 2008, respectively. At December 31, 2009 and 2008, impaired loans of $1,120,000 and $2,448,000 had no related allowance for loan losses.

Interest income of $66,000 and $141,000 was recognized on average impaired loans of $1,738,000 and $3,304,000 for 2009 and 2008. Interest income of $66,000 and $151,000 was recognized on impaired loans on a cash basis during 2009 and 2008.

At December 31, 2009 and 2008, accruing loans delinquent 90 days or more totaled $889,000 and $491,000, respectively. Nonaccruing loans at December 31, 2009 and 2008 were $787,000 and $1,822,000, respectively.

Note 7: Premises and Equipment

	2009	2008
Land	$ 77	$ 77
Buildings	1,238	1,234
Leasehold improvements	46	46
Equipment	1,304	1,291
Total cost	2,665	2,648
Accumulated depreciation and amortization	(2,010)	(1,918)
Net	$ 655	$ 730

Note 8: Deposits

	2009	2008
Demand deposits	$ 48,466	$ 53,734
Savings deposits	7,538	6,418
Certificates and other time deposits of $100,000 or more	10,608	7,246
Other certificates and time deposits	20,154	20,606
Total deposits	$ 86,766	$ 88,004

At December 31, 2009, the scheduled maturities of time deposits are as follows:

2010	$ 22,095
2011	3,152
2012	1,375
2013	2,413
2014	1,343
Thereafter	384
	$ 30,762

Note 9: Borrowings

The terms of a security agreement with the Federal Home Loan Bank requires the Bank to pledge as collateral for advances qualifying first mortgage loans or Agency securities in an amount equal to 170 percent of these advances. Advances are subject to restrictions or penalties in the event of prepayment and include rates from 0.47% to 5.27%. Federal Home Loan Bank advances totaled $26,200,000 and $24,000,000 at December 31, 2009 and 2008, respectively. Advances totaling $10,000,000 are subject to an option for the FHLB to convert the entire advance to a periodic adjustable rate one year after the date of the advance and quarterly thereafter. The adjustable rate would be for the remaining term at the predetermined rate. If the FHLB exercises its option to convert the advance to an adjustable rate, the advance will be prepayable at the Bancorp's option, at par and without a penalty.

Maturities of Federal Home Loan Bank advances were as follows at December 31, 2009:

2010	$	4,700
2011		4,500
2012		6,000
2013		7,000
2014		4,000
	$	26,200

The Bank has an available line of credit with the FRB totaling $5,000,000. There was no balance outstanding at December 31, 2009 and 2008, respectively. The FRB line of credit expires January 2, 2010 and is secured by certain municipal securities.

Note 10: Stockholders' Equity

Preferred Stock

The Company has authorized 250,000 shares of no par value preferred stock. The Company's Articles of Incorporation permit the Board of Directors, without further stockholder approval, to establish the relative rights, designations, preferences and limitations or restrictions of the Company's preferred stock prior to the issuance thereof. At December 31, 2009 and 2008, no preferred shares had been issued.

Stock Split

On July 1, 2008, the Company's Board of Directors declared a two-for-one stock split, effected in the form of a stock dividend, on the shares of the Company's common stock. Each shareholder of record on June 30, 2008, received an additional share of common stock for each share of common stock they held. The stock was issued July 1, 2008. All references in the financial statements to the number of shares outstanding and per share amounts of the Company's common stock have been restated to reflect the effect of the stock split for all periods presented.

Note 11: Income Tax

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. With a few exceptions, the Company is no longer subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for years before 2006.

	2009	2008
Income tax expense		
Currently payable		
Federal	$ 272	$ 280
State	86	130
Deferred		
Federal	(40)	(123)
State	(7)	(49)
Total income tax expense	$ 311	$ 238
Reconciliation of federal statutory to actual tax expense		
Federal statutory income tax at 34%	$ 425	$ 373
Tax exempt interest	(190)	(187)
Nondeductible expenses	-	3
Effect of state income taxes	52	53
Other	24	(4)
Actual tax expense	$ 311	$ 238

A cumulative net deferred tax asset is included in other assets. The components of the asset are as follows:

	2009	2008
Assets		
Depreciation	$ 19	$ 5
Allowance for loan losses	268	243
Deferred compensation	105	112
AMT credit	199	203
Investment impairment loss	-	241
Other	21	3
Total assets	612	807
Liabilities		
State income tax	(32)	(42)
FHLB stock	(62)	(61)
Securities available for sale	(267)	(127)
Other	(31)	(27)
Total liabilities	(392)	(257)
	$ 220	$ 550

Note 12: Other Comprehensive Income

	Before-Tax Amount	2009 Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized gains on securities:			
Unrealized holding gains arising during the year	$ 1,798	$ (712)	$ 1,086
Less: reclassification adjustment for gain realized in net income	855	(339)	516
	$ 943	$ (373)	$ 570

	Before-Tax Amount	2008 Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized gains on securities:			
Unrealized holding gains arising during the year	$ 411	$ (163)	$ 248
Less: reclassification adjustment for gain realized in net income	167	(66)	101
	$ 244	$ (97)	$ 147

Note 13: Commitments and Contingent Liabilities

In the normal course of business, there are outstanding commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying consolidated financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the consolidated balance sheet.

Financial instruments whose contract amount represents credit risk as of December 31 were as follows:

	2009	2008
Commitments to extend credit	$ 19,385	$ 15,663
Standby letters of credit	234	225

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness 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. Collateral held varies but may include accounts receivable, inventory, property and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party.

The Company and Bank have entered into an employment agreement with certain officers which provides for continuation of salary and certain benefits under certain conditions. Under the terms of the agreement, payment could occur in the event of a change in control of the Company or Bank, as defined, along with other specified conditions. The contingent liability under the agreement in the event of a change in control is approximately $622,000.

Note 14: Regulatory Capital

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies and is assigned to a capital category. The assigned capital category is largely determined by three ratios that are calculated according to the regulations: total risk adjusted capital, Tier 1 capital and Tier 1 leverage ratios. The ratios are intended to measure capital relative to assets and credit risk associated with those assets and off-balance sheet exposures of the entity. The capital category assigned to an entity can also be affected by qualitative judgments made by regulatory agencies about the risk inherent in the entity's activities that are not part of the calculated ratios.

There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations. At December 31, 2009 and 2008, the Bank is categorized as well capitalized and met all subject capital adequacy requirements. There are no conditions or events since December 31, 2009, that management believes have changed the Bank's classification.

The Bank's actual and required capital amounts and ratios are as follows:

	Actual		Minimum Required for Adequate Capital		Minimum Required To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2009						
Total capital (to risk-weighted assets)	$ 16,321	18.9%	$ 6,922	8.0%	$ 8,653	10.0%
Tier I capital (to risk-weighted assets)	15,238	17.6%	3,461	4.0%	5,192	6.0%
Tier I capital (to average assets)	15,238	11.4%	5,360	4.0%	6,701	5.0%
As of December 31, 2008						
Total capital (to risk-weighted assets)	$ 15,617	18.9%	$ 6,605	8.0%	$ 8,256	10.0%
Tier I capital (to risk-weighted assets)	14,529	17.6%	3,302	4.0%	4,954	6.0%
Tier I capital (to average assets)	14,529	11.1%	5,227	4.0%	6,534	5.0%

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. Generally, the Bank's payment of dividends is limited to net income for the current year plus the two preceding calendar years, less capital distributions paid over the comparable time period.

Note 15: Employee Benefits

The Bank has a profit-sharing plan which covers all officers and employees with one year of service and over age 21. The Bank has generally contributed the maximum permissible amount to the plan, which is 15% of covered wages. Employee benefits in the plan vest over a period of years and reach 100% after six years. The Bank's expense for the plan was $198,000 for 2009 and $214,000 for 2008.

Note 16: Related Party Transactions

The Bank has entered into transactions with certain directors, executive officers, significant stockholders and their affiliates or associates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. The aggregate amount of loans to such related parties at December 31, 2009 and 2008 was $2,307,000 and $2,039,000, respectively.

Deposits from related parties held by the Bank at December 31, 2009 and 2008 totaled $866,000 and $852,000, respectively.

Note 17: Disclosures About Fair Value of Assets and Liabilities

ASC Topic 820, *Fair Value Measurements*, defines fair value as 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. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

The following is 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.

Trading and Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include exchange traded preferred securities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions. Additionally, matrix pricing is used for certain investment securities and is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities. Level 2 securities include certain mortgage and debt obligations and certain municipal securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The following tables present the fair value measurements of assets and liabilities measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall:

		2009 Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Trading assets				
State and municipal	$ 2,329	$ -	$ 2,329	$ -
Federal agencies	8,153	-	8,153	-
State and municipal	29,598	-	29,598	-
Corporate	928	478	450	-
Mortgage-backed securities	11,213	-	11,213	-
	$ 52,221	$ 478	$ 51,743	$ -

		2008 Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Federal agencies	$ 11,143	$ -	$ 11,143	$ -
State and municipal	24,341	-	24,341	-
Corporate	616	200	416	-
Mortgage-backed securities	17,610	-	17,610	-
	$ 53,710	$ 200	$ 53,510	$ -

The following is a description of the valuation methodologies used for instruments measured at fair value on a non-recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans (Collateral Dependent)

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms, are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral-dependent loans.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value.

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

The following tables present the fair value measurements of assets and liabilities measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall:

		2009 Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 578	$ -	$ -	$ 578

		2008 Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 176	$ -	$ -	$ 176

The following table presents estimated fair values of the Company's financial instruments. The fair values of certain of these instruments were calculated by discounting expected cash flows, which involves significant judgments by management and uncertainties. Fair value is the estimated amount at which financial assets or liabilities could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Because no market exists for certain of these financial instruments and because management does not intend to sell these financial instruments, the Company does not know whether the fair values shown below represent values at which the respective financial instruments could be sold individually or in the aggregate.

	December 31, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 5,635	$ 5,635	$ 4,862	$ 4,862
Interest-bearing time deposits	500	500	-	-
Trading assets	2,329	2,329	-	-
Available-for-sale securities	49,892	49,892	53,710	53,710
Loans, net	65,793	65,873	65,710	-
Stock in FHLB	1,450	1,450	1,450	1,450
Interest receivable	1,466	1,466	1,472	1,472
Financial liabilities				
Deposits	86,766	87,261	88,004	83,840
Borrowings	26,200	26,999	24,000	22,568
Interest payable	144	144	219	219

For purposes of the above disclosures of estimated fair value, the following assumptions were used as of December 31, 2009 and 2008. The estimated fair value for cash and cash equivalents, interest-bearing time deposits, FHLB stock, accrued interest receivable, demand deposits, savings accounts, NOW accounts, certain money market deposits, short-term borrowings and interest payable is considered to approximate cost. The estimated fair value for securities and trading assets is based on quoted market values for the individual securities or for equivalent securities. The estimated fair value for loans receivable, net, is based on estimates of the rate the Bank would charge for similar loans at December 31, 2009 and 2008 applied for the time period until the loans are assumed to reprice or be paid. The estimated fair value for fixed-maturity time deposits as well as borrowings is based on estimates of the rate the Bank would pay on such liabilities at December 31, 2009 and 2008, applied for the time period until maturity.

Note 18: Condensed Financial Information (Parent Company Only)

Presented below is condensed financial information as to financial position, results of operations and cash flows of the Company:

Condensed Balance Sheets

	2009	2008
Assets		
Cash and due from banks	$ 63	$ 268
Investment in common stock of subsidiary	15,646	14,724
Other assets	135	99
Total assets	$ 15,844	$ 15,091
Other Liabilities	$ 19	$ -
Stockholders' Equity	15,825	15,091
Total liabilities and stockholders' equity	$ 15,844	$ 15,091

Condensed Statements of Income

	2009	2008
Income		
Dividends from subsidiary	$ 650	$ 2,337
Expenses		
Other expenses	91	76
Income Before Income Tax and Equity in Undistributed Income of Subsidiary	559	2,261
Income Tax Benefit	(36)	(30)
Income Before Equity in Undistributed Income of Subsidiary	595	2,291
Equity in Undistributed Income (Loss) of Subsidiary	352	(1,431)
Net Income	$ 947	$ 860

Condensed Statements of Cash Flows

	2009	2008
Operating Activities		
Net income	$ 947	$ 860
Adjustments to reconcile net income to net cash provided by (used in) operating activities	(369)	1,377
Net cash provided by operating activities	578	2,237
Financing Activities		
Cash dividends	(521)	(531)
Issuance of common stock	-	187
Purchase of common stock	(262)	(1,711)
Net cash used in financing activities	(783)	(2,055)
Net Change in Cash and Due From Banks	(205)	182
Cash and Due From Banks at Beginning of Year	268	86
Cash and Due From Banks at End of Year	$ 63	$ 268

Note 19: Subsequent Events

Subsequent events have been evaluated through March 15, 2010, which is the date the consolidated financial statements were available to be issued.

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JOHN S. FREELAND, Director
STEVEN T. PETTET, Director, President & CEO
C. KENT STEMBEL, Director
WILLIAM B. WEIST, Director, Vice Chairman
SHERYL D. RICHERT, Secretary
CYNTHIA L. EBERHARDT, Asst. Secretary

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STEVEN K. BRUNTON	Executive Vice President & CFO
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RICK J. MICKLE	Vice President, Controller & Investment Officer
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TRACI L. DAVIES	Vice President
CYNTHIA L. EBERHARDT	Vice President
LINDA I. BREWER	Cashier & Assistant Trust Officer
CHRISTOPHER C. WILLIAMS	Vice President & Williamsport Branch Manager
ANNE M. MOLTER	Senior Trust Officer & Vice President
JAMES D. REMSBURG	Senior Loan Officer
KASSEY L. BUDREAU	Assistant Vice President
KIM M. DATZMAN	Chief Technology Officer & Assistant Vice President
JANET M. GRETENCORD	Assistant Vice President
CURT A. PUETZ	Assistant Vice President & Loan Officer
DIANE L. ROSS	Assistant Vice President
MARIE L. ROWE	Assistant Vice President
LORI A. FRANCIS	Operations Officer & Assistant Trust Officer
MARY LOU HARDEBECK	Assistant Cashier
MARTHA L. SALLA	Assistant Cashier
KATHLEEN M. FLOOK	Auditor
PAMELA S. BENNER	Assistant Auditor

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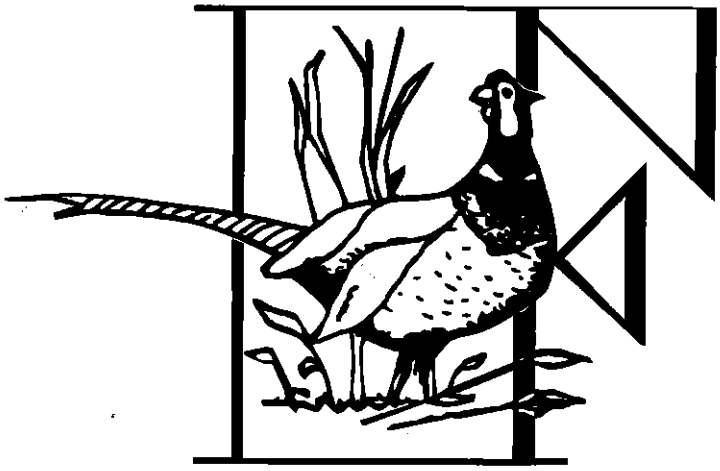

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