

MID PENN BANCORP INC  
Form 10-Q  
August 09, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**  
**FORM 10-Q**

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

**For the Quarterly Period Ended June 30, 2010**

**OR**

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

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

**Commission file number 001-13677**

**MID PENN BANCORP, INC.**

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

**Pennsylvania**  
**(State or Other Jurisdiction of**

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

**Incorporation or Organization)**

**349 Union Street**

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

**17061**  
**(Zip Code)**

**(717) 692-2133**

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

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

Yes ☒ No ☐

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

Yes ☐ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ☐ No ☒

As of August 9, 2010, there were 3,479,780 shares of the registrant's common stock outstanding, par value \$1.00 per share.

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| <i>Unless the context otherwise requires, the terms "Mid Penn", "we", "us", and "our" refer to Mid Penn Bancorp, Inc. and its consolidated subsidiaries.</i> |    |

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

| <b>(Dollars in thousands, except share data)</b>  | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---|--------------------------|------------------------------|
| <b>ASSETS</b>   |                          |                              |
| Cash and due from banks   | \$ 7,075                 | \$ 7,526                     |
| Interest-bearing balances with other financial institutions   | 1,007                    | 1,434                        |
| Federal funds sold  | 6,464                    |                              |
| <b>Total cash and cash equivalents</b>  | <b>14,546</b>            | <b>8,960</b>                 |
| Interest-bearing time deposits with other financial institutions  | 40,627                   | 38,604                       |
| Available for sale investment securities  | 57,229                   | 47,345                       |
| Loans and leases, net of unearned interest  | 472,702                  | 480,385                      |
| Less: Allowance for loan and lease losses   | (8,031)                  | (7,686)                      |
| <b>Net loans and leases</b>   | <b>464,671</b>           | <b>472,699</b>               |
| Bank premises and equipment, net  | 13,548                   | 12,904                       |
| Restricted investment in bank stocks  | 4,029                    | 4,029                        |
| Foreclosed assets held for sale   | 656                      | 663                          |
| Accrued interest receivable   | 2,682                    | 2,781                        |
| Deferred income taxes   | 2,908                    | 2,257                        |
| Goodwill  | 1,016                    | 1,016                        |
| Core deposit and other intangibles, net   | 354                      | 369                          |
| Cash surrender value of life insurance  | 7,504                    | 7,368                        |
| Other assets  | 5,725                    | 7,015                        |
| <b>Total Assets</b>   | <b>\$ 615,495</b>        | <b>\$ 606,010</b>            |
| <b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>   |                          |                              |
| Deposits:   |                          |                              |
| Noninterest bearing demand  | \$ 58,311                | \$ 55,943                    |
| Interest bearing demand   | 56,060                   | 42,148                       |
| Money Market  | 155,676                  | 107,295                      |
| Savings   | 26,678                   | 26,169                       |
| Time  | 235,395                  | 268,460                      |
| <b>Total Deposits</b>   | <b>532,120</b>           | <b>500,015</b>               |
| Short-term borrowings   | 2,111                    | 16,044                       |
| Long-term debt  | 27,971                   | 38,057                       |
| Accrued interest payable  | 2,005                    | 1,750                        |
| Other liabilities   | 3,326                    | 3,440                        |
| <b>Total Liabilities</b>  | <b>567,533</b>           | <b>559,306</b>               |
| Shareholders' Equity:   |                          |                              |
| Preferred stock, par value \$1,000; authorized 10,000,000 shares; 5% cumulative dividend; 10,000 shares issued and outstanding at June 30, 2010 and December 31, 2009 | 10,000                   | 10,000                       |
| Common stock, par value \$1 per share; 10,000,000 shares authorized; 3,479,780 shares issued and outstanding at June 30, 2010 and December 31, 2009                   | 3,480                    | 3,480                        |
| Additional paid-in capital  | 29,817                   | 29,824                       |

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|  |            |            |
|--|------------|------------|
| Retained earnings                          | 3,903      | 2,627      |
| Accumulated other comprehensive income     | 762        | 773        |
| Total Shareholders' Equity                 | 47,962     | 46,704     |
| Total Liabilities and Shareholders' Equity | \$ 615,495 | \$ 606,010 |

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

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

|  | <b>Three Months Ended<br/>June 30,</b> |              | <b>Six Months Ended<br/>June 30,</b> |               |
|--|--|--------------|--------------------------------------|---------------|
| <b>(Dollars in thousands, except per share data)</b>                               | <b>2010</b>                            | <b>2009</b>  | <b>2010</b>                          | <b>2009</b>   |
| <b>INTEREST INCOME</b>   |  |              |                                      |               |
| Interest & fees on loans and leases  | \$ 6,996                               | \$ 7,161     | \$ 13,708                            | \$ 13,804     |
| Interest on interest-bearing balances with financial institutions                  | 208                                    | 384          | 424                                  | 840           |
| Interest and dividends on investment securities:                                   |  |              |                                      |               |
| U.S. Treasury and government agencies  | 189                                    | 158          | 352                                  | 334           |
| State and political subdivision obligations, tax-exempt                            | 281                                    | 287          | 538                                  | 572           |
| Other securities   | 3                                      | 3            | 6                                    | 7             |
| Interest on federal funds sold and securities purchased under agreements to resell | 8                                      |              | 11                                   | 1             |
| <b>Total Interest Income</b>   | <b>7,685</b>                           | <b>7,993</b> | <b>15,039</b>                        | <b>15,558</b> |
| <b>INTEREST EXPENSE</b>  |  |              |                                      |               |
| Interest on deposits   | 2,348                                  | 2,609        | 4,820                                | 5,511         |
| Interest on short-term borrowings  | 2                                      | 40           | 13                                   | 59            |
| Interest on long-term debt   | 310                                    | 613          | 680                                  | 1,301         |
| <b>Total Interest Expense</b>  | <b>2,660</b>                           | <b>3,262</b> | <b>5,513</b>                         | <b>6,871</b>  |
| <b>Net Interest Income</b>   | <b>5,025</b>                           | <b>4,731</b> | <b>9,526</b>                         | <b>8,687</b>  |
| <b>PROVISION FOR LOAN AND LEASE LOSSES</b>   | <b>925</b>                             | <b>479</b>   | <b>1,085</b>                         | <b>1,412</b>  |
| <b>Net Interest Income After Provision for Loan and Lease Losses</b>               | <b>4,100</b>                           | <b>4,252</b> | <b>8,441</b>                         | <b>7,275</b>  |
| <b>NONINTEREST INCOME</b>  |  |              |                                      |               |
| Trust department income  | 50                                     | 62           | 104                                  | 123           |
| Service charges on deposits  | 324                                    | 386          | 656                                  | 737           |
| Earnings from cash surrender value of life insurance                               | 68                                     | 68           | 136                                  | 141           |
| Gain on life insurance proceeds  |  |              |                                      | 158           |
| Mortgage banking income  | 72                                     | 33           | 142                                  | 75            |
| Other income   | 387                                    | 312          | 679                                  | 568           |
| <b>Total Noninterest Income</b>  | <b>901</b>                             | <b>861</b>   | <b>1,717</b>                         | <b>1,802</b>  |
| <b>NONINTEREST EXPENSE</b>   |  |              |                                      |               |
| Salaries and employee benefits   | 2,156                                  | 2,021        | 4,262                                | 4,121         |
| Occupancy expense, net   | 194                                    | 231          | 449                                  | 436           |
| Equipment expense  | 335                                    | 306          | 693                                  | 544           |
| Pennsylvania Bank Shares tax expense   | 117                                    | 100          | 219                                  | 201           |
| FDIC Assessment  | 203                                    | 395          | 404                                  | 523           |
| Legal and professional fees  | 143                                    | 215          | 281                                  | 354           |
| Director fees and benefits expense   | 78                                     | 66           | 154                                  | 143           |
| Marketing and advertising expense  | 75                                     | 266          | 143                                  | 460           |
| Computer expense   | 124                                    | 120          | 260                                  | 223           |
| Telephone expense  | 92                                     | 82           | 179                                  | 158           |
| (Gain) Loss on sale/write-down of foreclosed assets                                | (12)                                   | 4            | 120                                  | 36            |
| Intangible amortization  | 16                                     | 16           | 32                                   | 32            |
| Other expenses   | 531                                    | 519          | 1,125                                | 978           |
| <b>Total Noninterest Expense</b>   | <b>4,052</b>                           | <b>4,341</b> | <b>8,321</b>                         | <b>8,209</b>  |

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|   |     |     |       |      |
|---|-----|-----|-------|------|
| INCOME BEFORE PROVISION FOR (BENEFIT FROM) INCOME TAXES | 949 | 772 | 1,837 | 868  |
| Provision for (benefit from) income taxes               | 158 | 59  | 311   | (58) |

|  |     |     |       |     |
|--|-----|-----|-------|-----|
| NET INCOME                                       | 791 | 713 | 1,526 | 926 |
| Preferred stock dividends and discount accretion | 129 | 129 | 257   | 257 |

|   |        |        |          |        |
|---|--------|--------|----------|--------|
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS | \$ 662 | \$ 584 | \$ 1,269 | \$ 669 |
|---|--------|--------|----------|--------|

## PER COMMON SHARE DATA:

|                                   |         |         |         |         |
|-----------------------------------|---------|---------|---------|---------|
| Basic Earnings Per Common Share   | \$ 0.19 | \$ 0.17 | \$ 0.36 | \$ 0.19 |
| Diluted Earnings Per Common Share | \$ 0.19 | \$ 0.17 | \$ 0.36 | \$ 0.19 |
| Cash Dividends                    | \$      | \$ 0.16 | \$      | \$ 0.36 |

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

**Table of Contents****MID PENN BANCORP, INC.****Consolidated Statements of Changes in Shareholder's Equity (Unaudited)**

FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009

|  | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Shareholders<br>Equity |
|--|--------------------|-----------------|----------------------------------|----------------------|---|---------------------------------|
| (Dollars in thousands, except share data)  |                    |                 |                                  |                      |   |                                 |
| <b>Balance, December 31, 2009</b>  | \$ 10,000          | \$ 3,480        | \$ 29,824                        | \$ 2,627             | \$ 773  | \$ 46,704                       |
| Comprehensive income:  |                    |                 |                                  |                      |   |                                 |
| Net income   |                    |                 |                                  | 1,526                |   | 1,526                           |
| Change in net unrealized loss on securities available for sale, net of tax effects |                    |                 |                                  |                      | (18)  | (18)                            |
| Defined benefit plans, net of tax effects  |                    |                 |                                  |                      | 7   | 7                               |
| Total comprehensive income   |                    |                 |                                  |                      |   | 1,515                           |
| Preferred dividends  |                    |                 |                                  | (250)                |   | (250)                           |
| Amortization of warrant cost   |                    |                 | (7)                              |                      |   | (7)                             |
| <b>Balance, June 30, 2010</b>  | \$ 10,000          | \$ 3,480        | \$ 29,817                        | \$ 3,903             | \$ 762  | \$ 47,962                       |
| <b>Balance, December 31, 2008</b>  | \$ 10,000          | \$ 3,480        | \$ 29,838                        | \$ 7,168             | \$ 404  | \$ 50,890                       |
| Comprehensive income:  |                    |                 |                                  |                      |   |                                 |
| Net income   |                    |                 |                                  | 926                  |   | 926                             |
| Change in net unrealized loss on securities available for sale, net of tax effects |                    |                 |                                  |                      | (334)   | (334)                           |
| Defined benefit plans, net of tax effects  |                    |                 |                                  |                      | 113   | 113                             |
| Total comprehensive income   |                    |                 |                                  |                      |   | 705                             |
| Cash dividends (\$0.20 per share)  |                    |                 |                                  | (1,253)              |   | (1,253)                         |
| Preferred dividends  |                    |                 |                                  | (186)                |   | (186)                           |
| Amortization of warrant cost   |                    |                 | (7)                              |                      |   | (7)                             |
| <b>Balance, June 30, 2009</b>  | \$ 10,000          | \$ 3,480        | \$ 29,831                        | \$ 6,655             | \$ 183  | \$ 50,149                       |

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



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

| (Dollars in thousands)  | Six Months Ended<br>June 30, |                 |
|---|------------------------------|-----------------|
|   | 2010                         | 2009            |
| <b>Operating Activities:</b>  |                              |                 |
| Net Income  | \$ 1,526                     | \$ 926          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |                 |
| Provision for loan and lease losses   | 1,085                        | 1,412           |
| Depreciation  | 643                          | 455             |
| Amortization of core deposit intangible   | 15                           | 21              |
| Net amortization of securities premiums   | 124                          | 36              |
| Earnings on cash surrender value of life insurance                                | (136)                        | (141)           |
| Gain from life insurance proceeds   |                              | (158)           |
| Loss on sale / write-down of foreclosed assets                                    | 120                          | 36              |
| Deferred income tax benefit   | (621)                        | (194)           |
| Decrease in accrued interest receivable   | 99                           |                 |
| Decrease in other assets  | 1,283                        | 127             |
| Increase in accrued interest payable  | 255                          | 330             |
| (Decrease) increase in other liabilities  | (114)                        | 248             |
| <b>Net Cash Provided by Operating Activities</b>                                  | <b>4,279</b>                 | <b>3,098</b>    |
| <b>Investing Activities:</b>  |                              |                 |
| Net (increase) decrease in interest-bearing time deposits                         | (2,023)                      | 10,331          |
| Proceeds from the maturity of investment securities                               | 4,378                        | 12,849          |
| Purchases of investment securities  | (14,413)                     |                 |
| Purchase of restricted investment in bank stock                                   |                              | (411)           |
| Net decrease (increase) in loans and leases                                       | 6,619                        | (33,091)        |
| Purchases of bank premises and equipment  | (1,287)                      | (1,293)         |
| Proceeds from sale of foreclosed assets   | 197                          | 768             |
| Proceeds from cash surrender value of life insurance                              |                              | 507             |
| <b>Net Cash Used in Investing Activities</b>                                      | <b>(6,529)</b>               | <b>(10,340)</b> |
| <b>Financing Activities:</b>  |                              |                 |
| Net increase in demand deposits and savings accounts                              | 65,170                       | 7,121           |
| Net decrease in time deposits   | (33,065)                     | (1,371)         |
| Net (decrease) increase in short-term borrowings                                  | (13,933)                     | 11,627          |
| Preferred stock dividend paid   | (250)                        | (203)           |
| Common stock dividend paid  |                              | (1,253)         |
| Long-term debt repayment  | (10,086)                     | (10,082)        |
| <b>Net Cash Provided by Financing Activities</b>                                  | <b>7,836</b>                 | <b>5,839</b>    |
| <b>Net increase (decrease) in cash and cash equivalents</b>                       | <b>5,586</b>                 | <b>(1,403)</b>  |
| Cash and cash equivalents, beginning of period                                    | 8,960                        | 8,448           |
| <b>Cash and cash equivalents, end of period</b>                                   | <b>\$ 14,546</b>             | <b>\$ 7,045</b> |
| <b>Supplemental Disclosures of Cash Flow Information:</b>                         |                              |                 |
| Interest paid   | \$ 5,258                     | \$ 6,541        |
| Income taxes paid   |                              |                 |
| <b>Supplemental Noncash Disclosures:</b>  |                              |                 |

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Transfers to foreclosed assets held for sale

\$ 324 \$ 138

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

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

### **Notes to Consolidated Financial Statements (Unaudited)**

#### ***1. Basis of Presentation***

The consolidated financial statements for 2010 and 2009 include the accounts of Mid Penn Bancorp, Inc. ( "Mid Penn" ), and its subsidiaries Mid Penn Bank (the "Bank" ), Mid Penn Insurance Services, LLC, and Mid Penn Investment Corporation (collectively the "Corporation" ). All material intercompany accounts and transactions have been eliminated in consolidation.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ( "GAAP" ) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ( "SEC" ). We believe the information presented is not misleading and the disclosures are adequate. For comparative purposes, the June 30, 2009 balances have been reclassified to conform to the 2010 presentation. Such reclassifications had no impact on net income. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year. These interim consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in Mid Penn's Annual Report on Form 10-K for the year ended December 31, 2009.

Mid Penn has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2010, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

#### ***2. Investment Securities***

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

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

Accounting Standards Codification ( "ASC" ) Topic 320, *Investments—Debt and Equity Securities*, clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. Previously, this assessment required management to assert it has both the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in fair value to avoid recognizing other-than-temporary impairment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price.

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

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

At June 30, 2010 and December 31, 2009, amortized cost, fair value, and unrealized gains and losses on investment securities are as follows:

| <b>(Dollars in thousands)</b>               | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
|---|---------------------------|-----------------------------|------------------------------|-----------------------|
| <b>June 30, 2010</b>                        |                           |                             |                              |                       |
| Available-for-sale securities:              |                           |                             |                              |                       |
| U.S. Treasury and U.S. government agencies  | \$ 18,274                 | \$ 665                      | \$ 2                         | \$ 18,937             |
| Mortgage-backed U.S. government agencies    | 12,097                    | 161                         | 25                           | 12,233                |
| State and political subdivision obligations | 25,397                    | 601                         | 188                          | 25,810                |
| Equity securities                           | 250                       |                             | 1                            | 249                   |
|   | \$ 56,018                 | \$ 1,427                    | \$ 216                       | \$ 57,229             |

| <b>(Dollars in thousands)</b>               | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
|---|---------------------------|-----------------------------|------------------------------|-----------------------|
| <b>December 31, 2009</b>                    |                           |                             |                              |                       |
| Available-for-sale securities:              |                           |                             |                              |                       |
| U.S. Treasury and U.S. government agencies  | \$ 15,291                 | \$ 409                      | \$                           | \$ 15,700             |
| Mortgage-backed U.S. government agencies    | 4,522                     | 97                          |                              | 4,619                 |
| State and political subdivision obligations | 26,044                    | 828                         | 91                           | 26,781                |
| Equity securities                           | 250                       |                             | 5                            | 245                   |
|   | \$ 46,107                 | \$ 1,334                    | \$ 96                        | \$ 47,345             |

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 June 30, 2010 and December 31, 2009, is reported at fair value.

Investment securities having a fair value of \$56,980,000 at June 30, 2010, and \$37,434,000 at December 31, 2009, were pledged to secure public deposits and other borrowings.

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### MID PENN BANCORP, INC.

### Notes to Consolidated Financial Statements (Unaudited)

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 June 30, 2010 and December 31, 2009.

|  | Less Than 12 Months<br>Fair<br>Value | Unrealized<br>Losses | 12 Months or More<br>Fair<br>Value | Unrealized<br>Losses | Total<br>Fair<br>Value | Total<br>Unrealized<br>Losses |
|--|--------------------------------------|----------------------|------------------------------------|----------------------|------------------------|-------------------------------|
| <b>(Dollars in thousands)</b>                            |                                      |                      |                                    |                      |                        |                               |
| June 30, 2010  |                                      |                      |                                    |                      |                        |                               |
| Available-for-sale securities:                           |                                      |                      |                                    |                      |                        |                               |
| U.S. Treasury and U.S. government agencies               | \$ 5,532                             | \$ 2                 | \$                                 | \$                   | \$ 5,532               | \$ 2                          |
| Mortgage-backed U.S. government agencies                 | 4,602                                | 25                   |                                    |                      | 4,602                  | 25                            |
| State and political subdivision obligations              | 6,401                                | 188                  |                                    |                      | 6,401                  | 188                           |
| Equity securities  |                                      |                      | 249                                | 1                    | 249                    | 1                             |
| Total temporarily impaired available for sale securities | \$ 16,535                            | \$ 215               | \$ 249                             | \$ 1                 | \$ 16,784              | \$ 216                        |

|  | Less Than 12 Months<br>Fair<br>Value | Unrealized<br>Losses | 12 Months or More<br>Fair<br>Value | Unrealized<br>Losses | Total<br>Fair<br>Value | Total<br>Unrealized<br>Losses |
|--|--------------------------------------|----------------------|------------------------------------|----------------------|------------------------|-------------------------------|
| <b>(Dollars in thousands)</b>                            |                                      |                      |                                    |                      |                        |                               |
| December 31, 2009  |                                      |                      |                                    |                      |                        |                               |
| Available-for-sale securities:                           |                                      |                      |                                    |                      |                        |                               |
| State and political subdivision obligations              | \$ 4,321                             | \$ 91                | \$                                 | \$                   | \$ 4,321               | \$ 91                         |
| Equity securities  |                                      |                      | 245                                | 5                    | 245                    | 5                             |
| Total temporarily impaired available for sale securities | \$ 4,321                             | \$ 91                | \$ 245                             | \$ 5                 | \$ 4,566               | \$ 96                         |

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 the length of time and the extent to which the fair value has been less than cost, and the financial condition and near term prospects of the issuer. In addition, for debt securities, Mid Penn considers (a) whether management has the intent to sell the security, (b) it is more likely than not that management will be required to sell the security prior to its anticipated recovery, and (c) whether management expects to recover the entire amortized cost basis. For equity securities, management considers the intent and ability to hold securities until recovery of unrealized losses.

At June 30, 2010, Mid Penn had 16 debt securities with unrealized losses. These securities have depreciated 1.31% from their amortized cost basis. At December 31, 2009, 8 debt securities with unrealized losses had depreciated 2.07% 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. Based on the above conditions management has determined that no declines are deemed to be other-than-temporary.

The table below is the maturity distribution of investment securities at amortized cost and fair value at June 30, 2010 and December 31, 2009:

|                                       | June 30, 2010     |               | December 31, 2009 |               |
|---------------------------------------|-------------------|---------------|-------------------|---------------|
|                                       | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
| <b>(Dollars in thousands)</b>         |                   |               |                   |               |
| Due in 1 year or less                 | \$ 3,131          | \$ 3,173      | \$ 1,022          | \$ 1,026      |
| Due after 1 year but within 5 years   | 11,579            | 11,799        | 11,878            | 12,121        |
| Due after 5 years but within 10 years | 17,092            | 17,911        | 17,662            | 18,417        |
| Due after 10 years                    | 11,869            | 11,864        | 10,773            | 10,917        |

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|                            |           |           |           |           |
|----------------------------|-----------|-----------|-----------|-----------|
|                            | 43,671    | 44,747    | 41,335    | 42,481    |
| Mortgage-backed securities | 12,097    | 12,233    | 4,522     | 4,619     |
| Equity securities          | 250       | 249       | 250       | 245       |
|                            | \$ 56,018 | \$ 57,229 | \$ 46,107 | \$ 47,345 |

Mortgage-backed securities at June 30, 2010, had an average life of 2.8 years compared to an average life of 2.6 years at December 31, 2009. New investment purchases in this category have longer average lives than the portfolio at December 31, 2009.

**Table of Contents****MID PENN BANCORP, INC.****Notes to Consolidated Financial Statements (Unaudited)****3. Fair Value Measurements**

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

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

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

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

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

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

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

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

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

There were no transfers of assets between fair value Level 1 and Level 2 for the six months ended June 30, 2010. 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<br>June 30, 2010 | Fair value measurements at June 30, 2010 using: |   |                                       |
|------------------------|--|---|---|---------------------------------------|
|                        |  | Quoted prices in<br>active<br>markets           | Significant other<br>observable inputs<br>(Level 2) | Significant<br>unobservable<br>inputs |

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|                               |    | (Level<br>1) |        | (Level 3) |
|-------------------------------|----|--------------|--------|-----------|
| <b>Assets:</b>                |    |              |        |           |
| Securities available for sale | \$ | 57,229       | \$ 249 | \$ 56,980 |

| Fair value measurements at December 31, 2009 using: |  |   |   |  |
|---|--|---|---|--|
| (Dollars in thousands)                              | Total carrying<br>value at<br>December 31,<br>2009 | Quoted<br>prices<br>in<br>active<br>markets<br>(Level<br>1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|   |  |   |   |  |
| <b>Assets:</b>                                      |  |   |   |  |
| Securities available for sale                       | \$   | 47,345  | \$ 245  | \$ 47,100  |

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).



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

| Fair value measurements at June 30, 2010 using: |  |   |   |  |
|---|--|---|---|--|
| (Dollars in thousands)                          |  | Quoted prices in<br>active<br>markets<br>(Level<br>1) | Significant other<br>observable inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|   | Total carrying value at<br>June 30, 2010 |   |   |  |
| <b>Assets:</b>                                  |  |   |   |  |
| Impaired Loans                                  | \$ 4,764                                 | \$  | \$  | \$ 4,764   |
| Foreclosed Assets                               | 656                                      |   |   | 656  |

| Fair value measurements at December 31, 2009 using: |   |   |  |  |
|---|---|---|--|--|
| (Dollars in thousands)                              |   | Quoted prices in<br>active<br>markets<br>(Level<br>1) | Significant other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|   | Total carrying value at<br>December 31,<br>2009 |   |  |  |
| <b>Assets:</b>                                      |   |   |  |  |
| Impaired Loans                                      | \$ 2,036  | \$  | \$   | \$ 2,036   |
| Foreclosed Assets                                   | 663   |   |  | 663  |

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets and non-financial liabilities measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. As stated above, this guidance was applicable to these fair value measurements beginning January 1, 2009 and the effect was not significant at June 30, 2010.

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

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

***Cash and Cash Equivalents:***

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

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

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

***Securities Available for Sale:***

The fair value of securities classified as available for sale is determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted prices.

***Impaired Loans:***

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Mid Penn's rating system assumes any loans classified as sub-standard non-accrual to be impaired, and all of these loans are considered collateral dependent; therefore, all of Mid Penn's impaired loans, whether reporting a specific allocation or not, are considered collateral dependent.

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate within 30 days of the credit being classified as sub-standard non-accrual. Prior to receipt of the updated real estate valuation Mid Penn will use any existing real estate valuation to determine any potential allowance issues; however no allowance recommendation will be made until which time Mid Penn is in receipt of the updated valuation.

In some instances Mid Penn is not holding real estate as collateral and is relying on business assets (personal property) for repayment. In these circumstances a collateral inspection is performed by Mid Penn personnel to determine an estimated value. The value is based on net book value, as provided by the financial statements, and discounted accordingly based on determinations made by management. Occasionally, Mid Penn will employ an outside service to provide a fair estimate of value based on auction sales or private sales. Management reviews the estimates of these third parties and discounts them accordingly based on management's judgment, if deemed necessary. Mid Penn considers the estimates used in its impairment analysis to be Level 3 inputs.

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values over time or changing circumstances by some factor, either positive or negative, from the original values. All collateral values will be assessed by management at least every 18 months for possible revaluation by an independent third party.

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**MID PENN BANCORP, INC.**

**Notes to Consolidated Financial Statements (Unaudited)**

Mid Penn does not currently, or plan to in the future, use automated valuation methodologies as a method of valuing real estate collateral.

***Loans:***

For variable-rate loans that reprice frequently and which entail no significant changes in credit risk, carrying values approximated fair value. The fair value of other loans are estimated by calculating the present value of the cash flow difference between the current rate and the market rate, for the average maturity, discounted quarterly at the market rate.

***Foreclosed Assets:***

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

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

The carrying amounts of accrued interest receivable and payable approximate their fair values.

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

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

***Deposits:***

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

***Short-term Borrowings:***

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

***Long-term Debt:***

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

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

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

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The following table summarizes the carrying value and fair value of financial instruments at June 30, 2010 and December 31, 2009.

|   | <b>June 30, 2010</b>  |                   | <b>December 31, 2009</b> |                   |
|---|-----------------------|-------------------|--------------------------|-------------------|
| <b>(Dollars in thousands)</b>                               | <b>Carrying Value</b> | <b>Fair Value</b> | <b>Carrying Value</b>    | <b>Fair Value</b> |
| <b>Financial assets:</b>                                    |                       |                   |                          |                   |
| Cash and cash equivalents                                   | \$ 14,546             | \$ 14,546         | \$ 8,960                 | \$ 8,960          |
| Interest-bearing balances with other financial institutions | 40,627                | 40,627            | 38,604                   | 38,604            |
| Investment securities                                       | 57,229                | 57,229            | 47,345                   | 47,345            |
| Net loans and leases  | 464,671               | 478,744           | 472,699                  | 487,476           |
| Restricted investment in bank stocks                        | 4,029                 | 4,029             | 4,029                    | 4,029             |
| Accrued interest receivable                                 | 2,682                 | 2,682             | 2,781                    | 2,781             |
| <b>Financial liabilities:</b>                               |                       |                   |                          |                   |
| Deposits  | \$ 532,120            | \$ 538,718        | \$ 500,015               | \$ 506,616        |
| Short-term borrowings                                       | 2,111                 | 2,111             | 16,044                   | 16,044            |
| Long-term debt  | 27,971                | 28,766            | 38,057                   | 39,578            |
| Accrued interest payable                                    | 2,005                 | 2,005             | 1,750                    | 1,750             |
| <b>Off-balance sheet financial instruments:</b>             |                       |                   |                          |                   |
| Commitments to extend credit                                | \$                    | \$                | \$                       | \$                |
| Financial standby letters of credit                         |                       |                   |                          |                   |

**4. Guarantees**

In the normal course of business, Mid Penn makes various commitments and incurs certain contingent liabilities, which are not reflected in the accompanying consolidated financial statements. The commitments include various guarantees and commitments to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Mid Penn evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Standby letters of credit and financial guarantees written are conditional commitments to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Mid Penn had \$11,789,000 and \$10,697,000 of standby letters of credit outstanding as of June 30, 2010 and December 31, 2009, respectively. Mid Penn does not anticipate any losses because of these transactions. The current amount of the liability as of June 30, 2010 for payment under standby letters of credit issued was not material.

**5. Short-term Borrowings**

Short-term borrowings as of June 30, 2010 and December 31, 2009 consisted of:

| <b>(Dollars in thousands)</b>               | <b>June 30, 2010</b> | <b>December 31, 2009</b> |
|---|----------------------|--------------------------|
| Federal funds purchased                     | \$                   | \$ 12,886                |
| Securities sold under repurchase agreements | 1,756                | 2,839                    |
| Treasury, tax and loan notes                | 355                  | 319                      |
|   | \$ 2,111             | \$ 16,044                |

Short-term borrowings are comprised primarily of federal funds purchased and securities sold under repurchase agreements. Investment securities are pledged in sufficient amounts to collateralize repurchase agreements. Treasury tax and loan notes are open-ended interest bearing

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notes payable to the U.S. Treasury upon call. All tax deposits accepted by the Bank are placed in the Treasury note option account.

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During the three and six months ended June 30, 2010, the Bank entered into no additional long-term borrowings with the Federal Home Loan Bank of Pittsburgh. During the three months ended June 30, 2010, no long-term borrowings with the Federal Home Loan Bank of Pittsburgh matured. During the six months ended June 30, 2010, \$10,000,000 in long-term borrowings with the Federal Home Loan Bank of Pittsburgh matured.

**7. Defined Benefit Plans**

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

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

| (Dollars in thousands)             | Three Months Ended June 30, |       |                |      |
|------------------------------------|-----------------------------|-------|----------------|------|
|                                    | Pension Benefits            |       | Other Benefits |      |
|                                    | 2010                        | 2009  | 2010           | 2009 |
| Service cost                       | \$ 6                        | \$ 5  | \$ 5           | \$ 4 |
| Interest cost                      | 13                          | 14    | 11             | 8    |
| Amortization of prior service cost | 5                           | 5     |                |      |
| Amortization of net gain           |                             |       | (3)            | (3)  |
| Net periodic benefit cost          | \$ 24                       | \$ 24 | \$ 13          | \$ 9 |

| (Dollars in thousands)             | Six Months Ended June 30, |       |                |       |
|------------------------------------|---------------------------|-------|----------------|-------|
|                                    | Pension Benefits          |       | Other Benefits |       |
|                                    | 2010                      | 2009  | 2010           | 2009  |
| Service cost                       | \$ 12                     | \$ 10 | \$ 10          | \$ 8  |
| Interest cost                      | 26                        | 28    | 22             | 16    |
| Amortization of prior service cost | 10                        | 10    |                |       |
| Amortization of net gain           |                           |       | (6)            | (6)   |
| Net periodic benefit cost          | \$ 48                     | \$ 48 | \$ 26          | \$ 18 |

**8. Comprehensive Income**

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

| (Dollars in thousands)   | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|--|-----------------------------|----------|---------------------------|----------|
|  | 2010                        | 2009     | 2010                      | 2009     |
| Change in unrealized holding gains (losses) on available for sale securities | \$ 235                      | \$ (612) | \$ (27)                   | \$ (489) |

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Less reclassification adjustment for gains realized in income

|                                   |        |          |         |          |
|-----------------------------------|--------|----------|---------|----------|
| Net unrealized gains (losses)     | 235    | (612)    | (27)    | (489)    |
| Change in defined benefit plans   | 3      | 3        | 9       | 155      |
| Other comprehensive income (loss) | 238    | (609)    | (18)    | (334)    |
| Income tax effect                 | (80)   | 207      | 7       | 113      |
| Net of tax amount                 | \$ 158 | \$ (402) | \$ (11) | \$ (221) |

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The components of accumulated other comprehensive income, net of taxes, are as follows:

| (Dollars in thousands) |                   | Unrealized Gain<br>on Securities | Defined Benefit<br>Plan<br>Liability | Accumulated<br>Other<br>Comprehensive<br>Income |
|------------------------|-------------------|----------------------------------|--------------------------------------|---|
| Balance                | June 30, 2010     | \$ 799                           | \$ (37)                              | \$ 762  |
| Balance                | December 31, 2009 | \$ 817                           | \$ (44)                              | \$ 773  |
| Balance                | June 30, 2009     | \$ 220                           | \$ (37)                              | \$ 183  |

**9. Preferred Stock**

On December 19, 2008, Mid Penn 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 Mid Penn 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 Mid Penn'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 pays cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. Pursuant to the American Recovery and Reinvestment Act of 2009, the Secretary of the Treasury is required to permit, subject to consultation with the appropriate Federal banking agency, Mid Penn to redeem the Series A Preferred Stock. Mid Penn may do so without regard to the source of the funds to be used to redeem the Series A Preferred Stock or any minimum waiting period. If Mid Penn elects to redeem the Series A Preferred Stock prior to February 15, 2012, and receives approval from the Treasury and the Board of Governors of the Federal Reserve System, it must redeem at least \$2,500,000 of the Series A Preferred Stock. Upon redemption of the Series A Preferred Stock, the Secretary of the Treasury must liquidate the warrants associated with Mid Penn's participation in the CPP at the current market price. Upon the appropriate approval, Mid Penn may redeem the Series A Preferred Stock at the original purchase price plus accrued but unpaid dividends, if any. The related Warrants expire in ten years and are immediately exercisable upon their issuance.

To participate in the program, Mid Penn 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 Mid Penn; (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 Mid Penn 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 are 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 can be declared or paid on common shares, nor can Mid Penn repurchase or redeem any common shares, unless all accrued and unpaid dividends for all past dividend periods on the Senior Preferred shares have been fully paid. In addition, the consent of the Treasury is 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 have been redeemed in whole or the Treasury has transferred all of the Senior Preferred shares to third parties.

**Repurchases**



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The Treasury's consent is 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 have been redeemed in whole or the Treasury has transferred all of the Senior Preferred shares to third parties. In addition, there can be no share repurchases of common shares if prohibited as described under "Restrictions on Dividends" above.

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The Senior Preferred shares are 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 are not paid in full for six dividend periods, whether or not consecutive, the Senior Preferred shareholder(s) have the right to elect two directors. The right to elect directors would end when full dividends have been paid for four consecutive dividend periods.

***10. Earnings per Common Share***

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

The computations of basic earnings per common share follow:

| (Dollars in thousands, except per share data) | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|---|-----------------------------|-----------|---------------------------|-----------|
|   | 2010                        | 2009      | 2010                      | 2009      |
| Net Income                                    | \$ 791                      | \$ 713    | \$ 1,526                  | \$ 926    |
| Less: Dividends on preferred stock            | (125)                       | (125)     | (250)                     | (250)     |
| Accretion of preferred stock discount         | (4)                         | (4)       | (7)                       | (7)       |
| Net income available to common shareholders   | \$ 662                      | \$ 584    | \$ 1,269                  | \$ 669    |
| Weighted average common shares outstanding    | 3,479,780                   | 3,479,780 | 3,479,780                 | 3,479,780 |
| Basic earnings per common share               | \$ 0.19                     | \$ 0.17   | \$ 0.36                   | \$ 0.19   |

The computations of diluted earnings per common share follow:

| (Dollars in thousands, except per share data)   | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|---|-----------------------------|-----------|---------------------------|-----------|
|   | 2010                        | 2009      | 2010                      | 2009      |
| Net income available to common shareholders   | \$ 662                      | \$ 584    | \$ 1,269                  | \$ 669    |
| Weighted average number of common shares outstanding  | 3,479,780                   | 3,479,780 | 3,479,780                 | 3,479,780 |
| Dilutive effect of potential common stock arising from stock warrants:                              |                             |           |                           |           |
| Exercise of outstanding stock warrants issued to U.S. Treasury under the Capital Repurchase Program |                             |           |                           |           |
| Adjusted weighted-average common shares outstanding   | 3,479,780                   | 3,479,780 | 3,479,780                 | 3,479,780 |
| Diluted earnings per common share   | \$ 0.19                     | \$ 0.17   | \$ 0.36                   | \$ 0.19   |

As of June 30, 2010, Mid Penn had 73,099 warrants that were anti-dilutive because the fair value of the common stock was below the \$20.52 exercise price of these warrants.

***11. Recent Accounting Pronouncements******ASU 2009-16:***

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In October 2009, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2009-16, *Transfers and Servicing (Topic 860) Accounting for Transfers of Financial Assets*. This Update amends the Codification for the issuance of FASB Statement No. 166, *Accounting for Transfers of Financial Assets-an amendment of FASB Statement No. 140*.

The amendments in this Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting.

This guidance became effective January 1, 2010, and did not have a significant impact on Mid Penn's financial condition or results of operations.

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**MID PENN BANCORP, INC.**

**Notes to Consolidated Financial Statements (Unaudited)**

***ASU 2010-06:***

The FASB has issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require:

A reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and

In the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements.

In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures:

For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and

A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

ASU 2010-06 is effective for interim and annual reporting periods beginning after January 1, 2010, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Mid Penn adopted the required provisions of ASU 2010-06, with no significant impact on its financial condition or results of operations.

***ASU 2010-09:***

The FASB has issued ASU 2010-09, *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements*. The amendments in the ASU remove the requirement for an SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of U.S. GAAP. The FASB also clarified that if the financial statements have been revised, then an entity that is not an SEC filer should disclose both the date that the financial statements were issued or available to be issued and the date the revised financial statements were issued or available to be issued. The FASB believes these amendments remove potential conflicts with the SEC's literature.

In addition, the amendments in the ASU require an entity that is a conduit bond obligor for conduit debt securities that are traded in a public market to evaluate subsequent events through the date of issuance of its financial statements and must disclose such date.

All of the amendments in the ASU were effective upon issuance (February 24, 2010) except for the use of the issued date for conduit debt obligors. That amendment was effective for interim or annual periods ending after June 15, 2010. Mid Penn adopted the required provisions of ASU 2010-09, with no significant impact on its financial condition or results of operations.

***ASU 2010-18:***

*Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset*, codifies the consensus reached in EITF Issue No. 09-I, *Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset*. The amendments to the Codification provide that modifications of loans that are accounted for within a pool under Subtopic 310-30 do

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not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change. ASU 2010-18 does not affect the accounting for loans under the scope of Subtopic 310-30 that are not accounted for within pools. Loans accounted for individually under Subtopic 310-30 continue to be subject to the troubled debt restructuring accounting provisions within Subtopic 310-40.

ASU 2010-18 is effective prospectively for modifications of loans accounted for within pools under Subtopic 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. Early application is permitted. Upon initial adoption of ASU 2010-18, an entity may make a one-time election to terminate accounting for loans as a pool under Subtopic 310-30. This election may be applied on a pool-by-pool basis and does not preclude an entity from applying pool accounting to subsequent acquisitions of loans with credit deterioration. The Corporation does not expect the adoption of this standard will have a significant impact on the Corporation's financial condition or results of operations.

### ***ASU 2010-20:***

*Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, will help investors assess the credit risk of a company's receivables portfolio and the adequacy of its allowance for credit losses held against the portfolios by expanding credit risk disclosures.

This ASU requires more information about the credit quality of financing receivables in the disclosures to financial statements, such as aging information and credit quality indicators. Both new and existing disclosures must be disaggregated by portfolio segment or class. The disaggregation of information is based on how a company develops its allowance for credit losses and how it manages its credit exposure.

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**MID PENN BANCORP, INC.**

**Notes to Consolidated Financial Statements (Unaudited)**

The amendments in this Update apply to all public and nonpublic entities with financing receivables. Financing receivables include loans and trade accounts receivable. However, short-term trade accounts receivable, receivables measured at fair value or lower of cost or fair value, and debt securities are exempt from these disclosure amendments.

The effective date of ASU 2010-20 differs for public and nonpublic companies. For public companies, the amendments that require disclosures as of the end of a reporting period are effective for periods *ending* on or after December 15, 2010. The amendments that require disclosures about activity that occurs during a reporting period are effective for periods *beginning* on or after December 15, 2010. For nonpublic companies, the amendments are effective for annual reporting periods ending on or after December 15, 2011. The Corporation does not expect the adoption of this standard will have a significant impact on the Corporation's financial condition or results of operations.

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**MID PENN BANCORP, INC.**

**Management's Discussion and Analysis**

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

The following is Management's Discussion of Consolidated Financial Condition as of June 30, 2010, compared to year-end 2009, and the Results of Operations for the three and six months ended June 30, 2010, compared to the same periods in 2009.

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

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

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

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

Governmental monetary and fiscal policies, as well as legislative and regulatory changes, including the effects of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act;

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

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

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

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

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

Technological changes;

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Acquisitions and integration of acquired businesses;

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

Acts of war or terrorism;

Volatilities in the securities markets; and

Deteriorating economic conditions.

Mid Penn undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review the risk factors described in the documents that we periodically file with the SEC, including Mid Penn's Annual Report on Form 10-K for the year ended December 31, 2009.

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

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

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

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



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

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

***Recent Legislation Affecting the Financial Services Industry***

On July 21, 2010, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") into law. The Dodd-Frank Act significantly changes regulation of financial institutions and the financial services industry, including: creating a Financial Services Oversight Council to identify emerging systemic risks and improve interagency cooperation; centralizing responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, which will be responsible for implementing, examining and enforcing compliance with federal consumer financial laws; permanently raising the current standard maximum deposit insurance amount to \$250,000; establishing strengthened capital standards for banks, and disallowing trust preferred securities from qualifying as Tier 1 capital (subject to certain grandfather provisions for existing trust preferred securities); establishing new minimum mortgage underwriting standards; granting the Federal Reserve Board the power to regulate debit card interchange fees; and implementing corporate governance changes. Many aspects of the Dodd-Frank are subject to rulemaking that will take effect over several years, thus making it difficult to assess the impact of the statute on the financial industry, including Mid Penn, at this time. Mid Penn is currently reviewing the provisions of the Dodd-Frank Act and assessing their probable impact on Mid Penn and its operations.

***Results of Operations******Overview***

Net income available to common shareholders was \$662,000 or \$0.19 per common share for the quarter ended June 30, 2010, as compared to net income available to common shareholders of \$584,000 or \$0.17 per common share for the quarter ended June 30, 2009. During the six months ended June 30, 2010, net income available to common shareholders was \$1,269,000 or \$0.36 per common share versus \$669,000 or \$0.19 per common share for the same period in 2009.

The net interest margin compression experienced throughout 2009 has begun to abate somewhat with net interest income increasing to \$5,025,000 during the three months ended June 30, 2010 from \$4,731,000 during the same period in 2009. The six months ended June 30, 2010 reflect an increasing level of net interest income as well, growing to \$9,526,000 versus \$8,687,000 during the same period in 2009. These increases have been spurred by a moderating cost of funds and increasing levels of average earning assets.

The provision for loan and lease losses in the second quarter of 2010 was \$925,000, as compared to \$479,000 in the second quarter of 2009. During the six months ended June 30, 2010, the provision for loan and lease losses was \$1,085,000 compared to \$1,412,000 for the six months ended June 30, 2009. Mid Penn continues to identify and responsibly provision for potential problem credits.

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

|                          | <b>Three Months Ended June 30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|--------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                          | <b>2010</b>                        | <b>2009</b> | <b>2010</b>                      | <b>2009</b> |
| Return on average assets | 0.51%                              | 0.50%       | 0.50%                            | 0.33%       |
| Return on average equity | 6.65%                              | 5.65%       | 6.48%                            | 3.51%       |

Total assets increased to \$615,495,000 at June 30, 2010, from \$606,010,000 at December 31, 2009. This asset increase was driven by strong core deposit growth to this point of 2010 with total deposits of \$532,120,000 at June 30, 2010 compared to \$500,015,000 at December 31, 2009, an increase of approximately \$32 million. This growth in core deposits led to an increase in federal funds sold and is being deployed to pay down long-term borrowings as they mature and into investments and loans to maximize the return on these new funds.

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The funding side of Mid Penn has continued the transformation begun in 2009. Deposit growth was strong, as noted above, during the first six months of 2010. This increase in deposits was primarily caused by successfully securing two long-term deposit relationships with local school districts, an attractive money market rate, and the building of relationship-based core deposit accounts from the extensive portfolio of commercial real estate borrowers. In addition to the ongoing efforts to place these funds into loans and investments, during the first six months of 2010, \$10,000,000 of long-term FHLB debt and \$6,990,000 in brokered time deposits have matured and been replaced with core deposits at a more advantageous rate structure. These strategies have improved the cost of funds and energized the net interest margin despite high levels of nonaccrual loans.

**Table of Contents****MID PENN BANCORP, INC.****Management's Discussion and Analysis***Net Interest Income/Funding Sources*

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

*Average Balances, Effective Interest Differential and Interest Yields*

Interest rates and interest differential – taxable equivalent basis

|  | For the Six Months Ended<br>June 30, 2010 |          |          | For the Six Months Ended<br>June 30, 2009 |          |          |
|--|---|----------|----------|---|----------|----------|
|  | Average<br>Balance                        | Interest | Rate (%) | Average<br>Balance                        | Interest | Rate (%) |
| <b>(Dollars in thousands)</b>                  |   |          |          |   |          |          |
| <b>ASSETS:</b>                                 |   |          |          |   |          |          |
| Interest Earning Balances                      | \$ 39,911                                 | \$ 424   | 2.14%    | \$ 43,393                                 | \$ 840   | 3.90%    |
| Investment Securities:                         |   |          |          |   |          |          |
| Taxable  | 24,026                                    | 358      | 3.00%    | 21,349                                    | 340      | 3.21%    |
| Tax-Exempt                                     | 25,470                                    | 815      | 6.45%    | 25,108                                    | 866      | 6.96%    |
| Total Investment Securities                    | 49,496                                    |          |          | 46,457                                    |          |          |
| Federal Funds Sold                             | 8,081                                     | 11       | 0.27%    | 517                                       | 1        |          |
| Loans and Leases, Net:                         |   |          |          |   |          |          |
| Taxable  | 459,041                                   | 13,332   | 5.86%    | 436,908                                   | 13,494   | 6.23%    |
| Tax-Exempt                                     | 16,976                                    | 570      | 6.77%    | 13,321                                    | 469      | 7.10%    |
| Total Loans and Leases, Net                    | 476,017                                   |          |          | 450,229                                   |          |          |
| Restricted Investment in Bank Stocks           | 4,029                                     |          | 0.00%    | 3,827                                     | 1        | 0.05%    |
| Total Earning Assets                           | 577,534                                   | 15,510   | 5.42%    | 544,423                                   | 16,011   | 5.93%    |
| Cash and Due from Banks                        | 7,888                                     |          |          | 6,410                                     |          |          |
| Other Assets                                   | 26,607                                    |          |          | 22,577                                    |          |          |
| Total Assets                                   | \$ 612,029                                |          |          | \$ 573,410                                |          |          |
| <b>LIABILITIES &amp; SHAREHOLDERS' EQUITY:</b> |   |          |          |   |          |          |
| Interest Bearing Deposits:                     |   |          |          |   |          |          |
| NOW  | \$ 48,703                                 | 30       | 0.12%    | \$ 36,514                                 | 17       | 0.09%    |
| Money Market                                   | 139,510                                   | 1,018    | 1.47%    | 76,665                                    | 621      | 1.63%    |
| Savings  | 27,203                                    | 8        | 0.06%    | 26,256                                    | 10       | 0.08%    |
| Time   | 252,145                                   | 3,764    | 3.01%    | 253,509                                   | 4,863    | 3.87%    |
| Short-term Borrowings                          | 5,540                                     | 13       | 0.47%    | 21,949                                    | 59       | 0.54%    |
| Long-term Debt                                 | 29,809                                    | 680      | 4.60%    | 50,430                                    | 1,301    | 5.20%    |
| Total Interest Bearing Liabilities             | 502,910                                   | 5,513    | 2.21%    | 465,323                                   | 6,871    | 2.98%    |
| Demand Deposits                                | 56,059                                    |          |          | 49,266                                    |          |          |

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|                      |        |        |
|----------------------|--------|--------|
| Other Liabilities    | 5,605  | 5,548  |
| Shareholders' Equity | 47,455 | 53,273 |

|  |            |            |
|--|------------|------------|
| Total Liabilities and Shareholders' Equity | \$ 612,029 | \$ 573,410 |
|--|------------|------------|

|                     |          |          |
|---------------------|----------|----------|
| Net Interest Income | \$ 9,997 | \$ 9,140 |
|---------------------|----------|----------|

|                                       |       |       |
|---------------------------------------|-------|-------|
| Net Yield on Interest Earning Assets: |       |       |
| Total Yield on Earning Assets         | 5.42% | 5.93% |
| Rate on Supporting Liabilities        | 2.21% | 2.98% |
| Average Interest Spread               | 3.21% | 2.95% |
| Net Interest Margin                   | 3.49% | 3.39% |

For the six months ended June 30, 2010, Mid Penn's taxable-equivalent net interest margin increased to 3.49% from 3.39% as compared to the six months ended June 30, 2009, driven primarily by a reduction in cost of supporting liabilities. Net interest income, on a taxable-equivalent basis, in the first six months of 2010 increased to \$9,997,000 from \$9,140,000 in the first six months of 2009, related to the changing composition of interest bearing liabilities and the growth in average earning assets, which increased 6.1% from June 30, 2009 to June 30, 2010.

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

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

*Provision for Loan Losses*

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

During the first six months of 2010, Mid Penn continued to experience a challenging economic and operating environment. Given the economic pressures that impact some borrowers, Mid Penn has increased the allowance for loan and lease losses in accordance with Mid Penn's assessment process, which took into consideration the decrease in collateral values from December 31, 2009 to June 30, 2010. The provision for loan and lease losses was \$925,000 for the three months ended June 30, 2010, as compared to \$479,000 for the three months ended June 30, 2009. During the six months ended June 30, 2010, the provision for loan and lease losses was \$1,085,000, as compared to \$1,412,000 for the six months ended June 30, 2009. For further discussion of factors affecting the provision for loan and lease losses please see *Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses* in the Financial Condition section of this Management's Discussion and Analysis.

*Noninterest Income*

Noninterest income increased \$40,000, or 4.7% during the second quarter of 2010 versus the second quarter of 2009. During the six months ended June 30, 2010, noninterest income decreased \$85,000, or 4.7% versus the same period in 2009. The following components of noninterest income showed significant changes:

| (Dollars in Thousands)      | Three Months Ended June 30, |        |             |            |
|-----------------------------|-----------------------------|--------|-------------|------------|
|                             | 2010                        | 2009   | \$ Variance | % Variance |
| Service charges on deposits | \$ 324                      | \$ 386 | \$ (62)     | -16.1%     |
| Mortgage banking income     | 72                          | 33     | 39          | 118.2%     |
| Other income                | 387                         | 312    | 75          | 24.0%      |

| (Dollars in Thousands)          | Six Months Ended June 30, |        |             |            |
|---------------------------------|---------------------------|--------|-------------|------------|
|                                 | 2010                      | 2009   | \$ Variance | % Variance |
| Service charges on deposits     | \$ 656                    | \$ 737 | \$ (81)     | -11.0%     |
| Gain on life insurance proceeds |                           | 158    | (158)       | N/A        |
| Mortgage banking income         | 142                       | 75     | 67          | 89.3%      |
| Other income                    | 679                       | 568    | 111         | 19.5%      |

Service charges on deposits, primarily fees from insufficient funds, showed decreases during both periods. During this period of economic downturn, customers seem to have become more conscientious about their account balances and avoiding unnecessary charges related to insufficient funds. The gain on life insurance proceeds in 2009 was the result of recognition of insurance proceeds due to the death of a former Director. Mortgage banking income showed increases during both periods. Decreases in long-term mortgage rates have spurred an increase in refinancing activity. During late 2009 and early 2010, Mid Penn enhanced the mortgage origination process by adding resources and improving processing capabilities which have generated additional revenue in 2010. Other income also increased during both periods. For the three months ended June 30, 2010, income from card interchange, merchant services, and commissions from third-party retail investment sales have increased \$18,000, \$12,000 and \$66,000 respectively over the same period in 2009. These increases have also positively impacted the results for the six months ended June 30, 2010 and are the result of a refreshed focus on these key business processes.



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

Noninterest expenses decreased \$289,000, or 6.7% during the second quarter of 2010, versus the same period in 2009. During the six months ended June 30, 2010, noninterest expenses increased \$112,000, or 1.4% versus the same period in 2009. The changes were primarily a result of the following components of noninterest expense:

| (Dollars in Thousands)            | Three Months Ended June 30, |        |             |            |
|-----------------------------------|-----------------------------|--------|-------------|------------|
|                                   | 2010                        | 2009   | \$ Variance | % Variance |
| FDIC Assessment                   | \$ 203                      | \$ 395 | \$ (192)    | -48.6%     |
| Marketing and advertising expense | 76                          | 266    | (190)       | -71.4%     |

  

| (Dollars in Thousands)            | Six Months Ended June 30, |          |             |            |
|-----------------------------------|---------------------------|----------|-------------|------------|
|                                   | 2010                      | 2009     | \$ Variance | % Variance |
| Salaries and employee benefits    | \$ 4,262                  | \$ 4,121 | \$ 141      | 3.4%       |
| Equipment expense                 | 693                       | 544      | 149         | 27.4%      |
| Marketing and advertising expense | 143                       | 460      | (317)       | -68.9%     |
| Other expenses                    | 1,125                     | 978      | 147         | 15.0%      |

The positive variance in FDIC Assessment during the three months ended June 30, 2010, was driven by special assessment charged in June of 2009 to all FDIC insured institutions. Assessment rates have increased; however, the prepayment of the three year estimated premiums in December of 2009 has stabilized Mid Penn's payment stream throughout 2010. Another positive variance during both periods was the decrease in marketing and advertising expense. This is reflective of Mid Penn's ongoing focus on spending only mission critical dollars. Equipment expense for the six months ended June 30, 2010 was impacted by the opening in April 2009 of Mid Penn's new operations facility in Halifax, the fourth quarter 2009 renovations of the Millersburg office, and the May 2010 opening of the relocated Derry Street facility in Harrisburg. These projects increased equipment expense, primarily depreciation costs, but provided much needed space for current operations, future growth, and enhanced community visibility. Salaries and employee benefits have shown a modest increase during the first six months of 2010 versus the same period in 2009 due to the hiring of experienced team members to bolster the credit administration functions. These necessary additions have been partially offset by savings in discretionary employee benefit plans during the same time period. Other expenses have increased during the first six months of 2010 versus the same period in 2009 due to increased costs surrounding loan collection and workout efforts as the pool of nonperforming assets is actively managed.

*Income Taxes*

The provision for income taxes was \$158,000 for the three months ended June 30, 2010, as compared to a provision for income taxes of \$59,000 in the same period last year. The provision for income taxes in the three months ended June 30, 2009, was at a level significantly below that of the same period in 2010 because of reduced income from lower net interest income and higher expenses for FDIC assessment and marketing and advertising expenses. The provision for income taxes for the six months ended June 30, 2010 was \$311,000, as compared to a benefit from income taxes during the same period of 2009 of (\$58,000). The tax benefit in 2009 was related to the reduced income stemming from the increased provision for loan and lease losses during the first six months of 2009. The effective tax rate, for the six months ended June 30, 2010, was 16.9 % compared to (6.7)% for the six months ended June 30, 2009. Generally, our effective tax rate is below the statutory rate due to earnings on tax-exempt loans, investments, and bank-owned life insurance, and the impact of tax credits. The realization of deferred tax assets is dependent on future earnings. As a result of Mid Penn's adoption of ASC Topic 740, *Income Taxes*, no significant income tax uncertainties were identified; therefore, Mid Penn recognized no adjustment for unrealized income tax benefits for the periods ended June 30, 2010 and June 30, 2009. We currently anticipate that future earnings will be adequate to fully utilize deferred tax assets.

*Financial Condition**Loans*

During the first six months of 2010, Mid Penn has experienced a reduction in loans outstanding, primarily from decreasing balances in the consumer loan portfolio. The balances in the other components of the loan portfolio have remained relatively unchanged with the exception of a

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modest increase in commercial, industrial, and agricultural loans. Mid Penn has experienced weak loan demand during the first six months of 2010 despite a desire to sensibly lend to support creditworthy existing and new customers in our marketplace.

| (Dollars in thousands)                                    | June 30, 2010 |        | December 31, 2009 |        |
|---|---------------|--------|-------------------|--------|
|   | Amount        | %      | Amount            | %      |
| Commercial real estate, construction and land development | \$ 253,650    | 53.7%  | \$ 253,878        | 52.8%  |
| Commercial, industrial and agricultural                   | 86,511        | 18.3%  | 85,795            | 17.9%  |
| Real estate - residential                                 | 128,037       | 27.1%  | 128,522           | 26.8%  |
| Consumer  | 4,504         | 0.9%   | 12,190            | 2.5%   |
|   | \$ 472,702    | 100.0% | \$ 480,385        | 100.0% |



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

Most of Mid Penn's lending activities are with customers located within the trading area of Dauphin County, lower Northumberland County, western Schuylkill County and eastern Cumberland County, Pennsylvania. This region currently and historically has lower unemployment than the U.S. as a whole. At June 30, 2010 the unemployment rate for the Harrisburg/Carlisle area was 8.4% versus the national unemployment rate of 9.5%. This is due in part to a diversified manufacturing and services base and the presence of state government offices which help shield the local area from national trends.

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

During the first six months of 2010, Mid Penn had net charge-offs of \$740,000 as compared to net charge-offs of \$287,000 during the same period of 2009. Mid Penn may need to make future adjustments to the allowance and the provision for loan and lease losses, if economic conditions or loan credit quality differs substantially from the assumptions used in making Mid Penn's evaluation of the level of the allowance for loan losses as compared to the balance of outstanding loans.

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

| (Dollars in thousands)   | Six Months Ended<br>June 30, 2010 | Six Months Ended<br>June 30, 2009 |
|--|-----------------------------------|-----------------------------------|
| Average total loans outstanding (net of unearned income)                 | \$ 476,017                        | \$ 450,229                        |
| Period ending total loans outstanding (net of unearned income)           | \$ 472,702                        | \$ 467,309                        |
| Balance, beginning of period   | \$ 7,686                          | \$ 5,505                          |
| Loans charged off during period  | (789)                             | (349)                             |
| Recoveries of loans previously charged off                               | 49                                | 62                                |
| Net chargeoffs   | (740)                             | (287)                             |
| Provision for loan and lease losses                                      | 1,085                             | 1,412                             |
| Balance, end of period   | \$ 8,031                          | \$ 6,630                          |
| Ratio of net loans charged off to average loans outstanding (annualized) | 0.31%                             | 0.13%                             |
| Ratio of allowance for loan losses to net loans at end of period         | 1.70%                             | 1.42%                             |

Other than as described herein, we do not believe there are any trends, events or uncertainties that are reasonably expected to have a material impact on future results of operations, liquidity, or capital resources. Further, based on known information, we believe that the effects of current and past economic conditions and other unfavorable business conditions may influence certain borrowers' abilities to comply with their repayment terms. Mid Penn continues to monitor closely the financial strength of these borrowers. Mid Penn does not engage in practices which may be used to artificially shield certain borrowers from the negative economic or business cycle effects that may compromise their ability to repay. Mid Penn does not structure construction loans with interest reserve components. Mid Penn has not in the past performed any commercial real estate or other type loan workouts whereby an existing loan was restructured into multiple new loans. Also, Mid Penn does not extend loans at maturity without recognizing the credit as impaired due to the existence of guarantees. While the existence of a guarantee may be a mitigating factor in determining the proper level of allowance once impairment has been identified, the guarantee does not affect the impairment analysis.

At June 30, 2010, total nonperforming loans amounted to \$18,763,000, or 3.97% of loans and leases net of unearned income, as compared to levels of \$15,241,000, or 3.17%, at December 31, 2009 and \$4,192,000, or 0.90%, at June 30, 2009. Nonperforming loans have been reduced from the \$20,383,000, or 4.30% of loans and leases net of unearned income reported at March 31, 2010.



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

| <b>(Dollars in thousands)</b>  | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> | <b>June 30,<br/>2009</b> |
|--|--------------------------|------------------------------|--------------------------|
| <b>Nonperforming Assets:</b>   |                          |                              |                          |
| Nonaccrual loans   | \$ 18,433                | \$ 14,933                    | \$ 4,145                 |
| Loans renegotiated with borrowers  | 330                      | 308                          | 47                       |
| <br>Total nonperforming loans  | <br>18,763               | <br>15,241                   | <br>4,192                |
| Foreclosed real estate   | 656                      | 663                          | 850                      |
| Other repossessed property   |                          |                              | 53                       |
| <br>Total non-performing assets  | <br>19,419               | <br>15,904                   | <br>5,095                |
| Accruing loans 90 days or more past due                                      | 372                      | 661                          | 1,102                    |
| <br>Total risk elements  | <br>\$ 19,791            | <br>\$ 16,565                | <br>\$ 6,197             |
| <br>Nonperforming loans as a % of total loans outstanding                    | <br>3.97%                | <br>3.17%                    | <br>0.90%                |
| Nonperforming assets as a % of total loans outstanding and other real estate | 4.10%                    | 3.31%                        | 1.09%                    |
| Ratio of allowance for loan losses to nonperforming loans                    | 42.80%                   | 50.43%                       | 158.16%                  |

Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans prior to charging down or charging off the loan. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact and is not treated as a restructured credit. The following table provides additional analysis of partially charged-off loans:

*Schedule of Partially Charged-Off Loans:*

| <b>(Dollars in thousands)</b>   | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---|--------------------------|------------------------------|
| Period ending total loans outstanding (net of unearned income)                                | \$ 472,702               | \$ 480,385                   |
| Allowance for loan and lease losses   | 8,031                    | 7,686                        |
| Total Nonperforming loans   | 18,763                   | 15,241                       |
| Nonperforming and impaired loans with partial charge-offs                                     | 6,213                    | 7,963                        |
| <br>Ratio of nonperforming loans with partial charge-offs to total loans                      | <br>1.31%                | <br>1.66%                    |
| Ratio of nonperforming loans with partial charge-offs to total nonperforming loans            | 33.11%                   | 52.25%                       |
| Coverage ratio net of nonperforming loans with partial charge-offs                            | 63.99%                   | 105.61%                      |
| <br>Ratio of total allowance to total loans less nonperforming loans with partial charge-offs | <br>1.72%                | <br>1.63%                    |

Mid Penn has not experienced any additional charge-offs on loans which a partial charge-off had originally been taken.

Mid Penn considers a commercial or commercial real estate loan to be impaired when it becomes 90 days or more past due and not in the process of collection. This methodology assumes the borrower cannot or will not continue to make additional payments. At that time the loan would be considered collateral dependent as the discounted cash flow ( DCF ) method indicates no operating income is available for evaluating the collateral position; therefore, all impaired loans are deemed to be collateral dependent.

Mid Penn evaluates loans for charge-off on a monthly basis. Policies that govern the recommendation for charge-off are unique to the type of loan being considered. Commercial loans rated as nonaccrual or lower will first have a collateral evaluation completed in accordance with the

guidance on impaired loans. Once the collateral evaluation has been completed, a specific allocation of allowance is made based upon the results of the

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

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

evaluation. In the event the loan is unsecured, the loan would have been charged-off at the recognition of impairment. If the loan is secured, it will undergo a 90 day waiting period to ensure the collateral shortfall identified in the evaluation is accurate and then charge the balance down to the specific allocation. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). Commercial real estate loans rated as impaired will also have an initial collateral evaluation completed in accordance with the guidance on impaired loans. An updated real estate valuation is ordered and the collateral evaluation is modified to reflect any variations in value. A specific allocation of allowance is made for any anticipated collateral shortfall and a 90 day waiting period begins to ensure the accuracy of the collateral shortfall. The loan is then charged down to the level of the specific allocation. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). The process of charge-off for residential mortgage loans begins upon a loan becoming delinquent for 90 days and not in the process of collection. The existing appraisal is reviewed and a lien search is obtained to determine lien position and any instances of intervening liens. A new appraisal of the property will be ordered if deemed necessary by management and a collateral evaluation is completed. The loan will then be charged down to the value indicated in the evaluation. Consumer loans are recommended for charge-off after reaching delinquency of 90 days and the loan is not in the process of collection. The entire balance of the consumer loan is recommended for charge-off at this point.

As noted above, Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans prior to charging down or charging off the loan. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In addition, Mid Penn takes a preemptive step when any commercial loan or commercial real estate loan becomes classified under its internal classification system. A preliminary collateral evaluation in accordance with the guidance on impaired loans is prepared using the existing collateral information in the loan file. This process allows Mid Penn to review both the credit and documentation files to determine the status of the information needed to make a collateral evaluation. This collateral evaluation is preliminary but allows Mid Penn to determine if any potential collateral shortfalls exist.

Larger groups of small-balance loans, such as residential mortgages and consumer installment loans are collectively evaluated for impairment. Accordingly, individual consumer and residential loans are not separately identified for impairment disclosures unless such loans are the subject of a restructuring agreement.

Mid Penn's rating system assumes any loans classified as sub-standard non-accrual to be impaired, and all of these loans are considered collateral dependent; therefore, all of Mid Penn's impaired loans, whether reporting a specific allocation or not, are considered collateral dependent.

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate within 30 days of the credit being classified as sub-standard non-accrual. Prior to receipt of the updated real estate valuation Mid Penn will use any existing real estate valuation to determine any potential allowance issues; however no allowance recommendation will be made until which time Mid Penn is in receipt of the updated valuation. The credit department employs an electronic tracking system to monitor the receipt of and need for updated appraisals. To date, there have been no significant time lapses noted with the above processes.

In some instances Mid Penn is not holding real estate as collateral and is relying on business assets (personal property) for repayment. In these circumstances a collateral inspection is performed by Mid Penn personnel to determine an estimated value. The value is based on net book value, as provided by the financial statements, and discounted accordingly based on determinations made by management. Occasionally, Mid Penn will employ an outside service to provide a fair estimate of value based on auction sales or private sales. Management reviews the estimates of these third parties and discounts them accordingly based on management's judgment, if deemed necessary.

For impaired loans with no valuation allowance required, Mid Penn's practice of obtaining independent third party market valuations on the subject property within 30 days of being placed on non-accrual status sometimes indicates that the loan to value ratio is sufficient to obviate the need for a specific allocation in spite of significant deterioration in real estate values in Mid Penn's primary market area. These circumstances are determined on a case by case analysis of the impaired loans.

Since December 31, 2009, Mid Penn has been actively seeking independent third party real estate valuations of the properties held as collateral on impaired loans. As of June 30, 2010, there were 9 loans with an outstanding balance of \$2,273,000 for which Mid Penn has not received a formal valuation.

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values over time or changing circumstances by some factor, either positive or negative, from the original values. All collateral values will be assessed by management at least every 18 months for possible revaluation by an independent third party.

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Mid Penn does not currently, or plan to in the future to, use automated valuation methodologies as a method of valuing real estate collateral.

As of June 30, 2010, Mid Penn had several unrelated loan relationships, with an aggregate carrying balance of \$16,747,000, deemed impaired. This pool of loans is further broken down into a group of loans with an aggregate carrying balance of \$7,550,000 for which specific allocations totaling \$2,786,000 have been included within the loan loss reserve for these loans. The remaining \$9,197,000 of loans requires no specific allocation within the loan loss reserve. The \$16,747,000 pool of impaired loan relationships is comprised of \$8,794,000 in real estate secured commercial relationships

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

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

and \$7,953,000 in business relationships. The Bank has specific allocations against the real estate secured pool totaling \$904,000, of which \$365,000 is with one investment property relationship. Another \$223,000 of the specific allocation is with a commercial business relationship secured by the Company's real estate. The remaining \$316,000 is spread among seven relationships composed primarily of customers engaged in real estate investment activities. The group of impaired business relationships with specific allocations is made up of eleven relationships primarily engaged in various forms of manufacturing and a specific allocation of \$1,882,000 has been set aside against these credits. Four manufacturing relationships account for \$1,043,000 of the specific allocations due to the negative effects of the economy on their businesses and the subsequent collateral devaluation. One additional large commercial participation loan in this pool has shown exceptional collateral devaluation and is responsible for a specific allocation of \$400,000 of the total pool attributable to this segment. Management currently believes that the specific reserves are adequate to cover potential future losses related to these relationships.

The allowance for loan losses is a reserve established in the form of a provision expense for loan and lease losses and is reduced by loan charge-offs net of recoveries. Management has established a reserve that it believes is adequate for probable losses in the loan and lease portfolio. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risk on a monthly basis so that an appropriate allowance is maintained. Based on an evaluation of the loan portfolio, management presents a monthly review of the allowance for loan and lease losses to the Board of Directors, indicating any changes in the allowance since the last review. In making the evaluation, management considers the results of recent regulatory examinations, which typically include a review of the allowance for loan and lease losses an integral part of the examination process.

In establishing the allowance, management evaluates on a quantitative basis individual classified loans and nonaccrual loans, and determines an aggregate reserve for those loans based on that review. In addition, an allowance for the remainder of the loan and lease portfolio is determined based on historical loss experience within certain components of the portfolio. These allocations may be modified if current conditions indicate that loan and lease losses may differ from historical experience.

In addition, a portion of the allowance is established for losses inherent in the loan and lease portfolio which have not been identified by the quantitative processes described above. This determination inherently involves a higher degree of subjectivity, and considers risk factors that may not have yet manifested themselves in historical loss experience. These factors include:

Changes in local, regional, and national economic and business conditions affecting the collectability of the portfolio, the values of underlying collateral, and the condition of various market segments.

Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified loans.

Changes in the experience, ability, and depth of lending management and other relevant staff as well as the quality of the institution's loan review system.

Changes in the nature and volume of the portfolio and the terms of loans generally offered.

The existence and effect of any concentrations of credit and changes in the level of such concentrations.

While the allowance for loan and lease losses is maintained at a level believed to be adequate by management for covering estimated losses in the loan and lease portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. Changes in these estimates may impact the provisions charged to expense in future periods.

Management believes, based on information currently available, that the allowance for loan and lease losses of \$8,031,000 is adequate as of June 30, 2010.

*Liquidity*

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

A growing core deposit base;

Proceeds from the sale or maturity of investment securities;

Proceeds from certificates of deposit in other financial institutions;

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

Overnight correspondent bank borrowings on various credit lines; and,

Borrowing capacity available from the FHLB.

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



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

Shareholders' equity, or capital, is evaluated in relation to total assets and the risk associated with those assets. The greater a corporation's capital resources, the more likely it is to meet its cash obligations and absorb unforeseen losses. Too much capital, however, indicates that not enough of the corporation's earnings have been paid to shareholders and the buildup makes it difficult for a corporation to offer a competitive return on the shareholders' capital going forward. For these reasons capital adequacy has been, and will continue to be, of paramount importance.

Capital growth is achieved primarily by retaining more earnings than are paid out to shareholders. Shareholders' equity increased during the quarter ended June 30, 2010 by \$1,258,000 or 2.70%, from December 31, 2009. Capital was negatively impacted in 2009 by the net loss of \$2,809,000 and the payment of cash dividends to common shareholders of \$1,809,000. 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.

Certain restrictions exist regarding the ability of the Bank to transfer funds to Mid Penn Bancorp, Inc. in the form of cash dividends, loans or advances. At June 30, 2010, none of the undistributed earnings of the Bank included in the consolidated shareholders' equity was available for distribution to Mid Penn as dividends without prior regulatory approval, subject to regulatory capital requirements below.

Mid Penn maintained the following regulatory capital levels, leverage ratios, and risk-based capital ratios in its bank subsidiary as of June 30, 2010, and December 31, 2009, as follows:

| (Dollars in thousands)                        | Capital Adequacy |       |                           |       | To Be Well-Capitalized Under Prompt Corrective Action Provisions: |       |
|---|------------------|-------|---------------------------|-------|---|-------|
|   | Actual:          |       | Minimum Capital Required: |       | Amount Ratio  |       |
|   | Amount           | Ratio | Amount                    | Ratio | Amount  | Ratio |
| As of June 30, 2010:                          |                  |       |                           |       |   |       |
| Tier 1 Capital (to Average Assets)            | \$ 45,866        | 7.5%  | \$ 24,622                 | 4.0%  | \$ 30,778   | 5.0%  |
| Tier 1 Capital (to Risk Weighted Assets)      | 45,866           | 9.8%  | 18,779                    | 4.0%  | 28,168  | 6.0%  |
| Total Capital (to Risk Weighted Assets)       | 51,762           | 11.0% | 37,558                    | 8.0%  | 46,947  | 10.0% |
| As of December 31, 2009:                      |                  |       |                           |       |   |       |
| Tier 1 Capital (to Average Assets)            | \$ 44,434        | 7.4%  | \$ 23,913                 | 4.0%  | \$ 29,892   | 5.0%  |
| Tier 1 Capital (to Risk Weighted Assets)      | 44,434           | 9.2%  | 19,329                    | 4.0%  | 28,993  | 6.0%  |
| Total Capital (to Risk Weighted Assets)       | 50,496           | 10.4% | 38,658                    | 8.0%  | 48,322  | 10.0% |
| <i>Capital Purchase Program Participation</i> |                  |       |                           |       |   |       |

On December 19, 2008, Mid Penn entered into an 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 Mid Penn under the Treasury's Capital Purchase Program (the "CPP").

Under the Purchase Agreement, the Treasury received (1) 10,000 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock, \$1,000 liquidation preference, and (2) Warrants to purchase up to 73,099 shares of the Mid Penn'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, Mid Penn's

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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 Mid Penn's next annual meeting of shareholders or special meeting of shareholders called for that purpose. These preferred share directors would be elected annually and serve until all accrued and unpaid dividends on the preferred shares have been paid.

Pursuant to the American Recovery and Reinvestment Act of 2009 (ARRA), the Secretary of the Treasury is required to permit, subject to consultation with the appropriate Federal banking agency, Mid Penn to redeem the Series A Preferred Stock. Mid Penn may do so without regard to the source of the funds to be used to redeem the Series A Preferred Stock or any minimum waiting period. If Mid Penn elects to redeem the Series A Preferred Stock prior to February 15, 2012, and receives approval from the Treasury and the Board of Governors of the Federal Reserve System, it must redeem at least \$2,500,000 of the Series A Preferred Stock. Upon redemption of the Series A Preferred Stock, the Secretary of the Treasury is required to liquidate the warrants associated with Mid Penn's participation in the CPP at the current market price. Any redemption is subject to the consent of the Board of Governors of the Federal Reserve System. Until December 19, 2011, or such earlier time as all preferred shares have been redeemed by Mid Penn or transferred by Treasury to third parties that are not affiliated with Treasury, Mid Penn may not, without Treasury's consent, increase its dividend rate per share of common stock above the per share quarterly amount in effect immediately prior to October 14, 2008 (\$0.20 per share) or, with certain limited exceptions, repurchase its common stock.

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**Management's Discussion and Analysis**

The warrants are immediately exercisable and have a 10-year term. The exercise price and number of shares subject to the warrants are both subject to anti-dilution adjustments. Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the warrants; however, this agreement not to vote the shares does not apply to any person who may acquire such shares.

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

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

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

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

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

No material changes in the market risk strategy occurred during the current period and no material changes have been noted in Mid Penn's equity value at risk. A detailed discussion of market risk is provided in the Form 10-K for the year ended December 31, 2009. Mid Penn enjoys a closely balanced position that does not place it at undue risk under any interest rate scenario. Deposit dollars in transaction accounts are discretionarily priced so management maintains significant pricing flexibility.

#### **ITEM 4 CONTROLS AND PROCEDURES**

##### ***Evaluation of Disclosure Controls and Procedures***

Mid Penn maintains controls and procedures designed to ensure that information required to be disclosed in the reports that Mid Penn files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures as of June 30, 2010, Mid Penn's management, with the participation of the Principal Executive Officer and Principal Financial and Accounting Officer, concluded that the disclosure controls and procedures were effective as of such date.

##### ***Changes in Internal Controls***

During the six months ended June 30, 2010, there were no changes in Mid Penn's internal control over financial reporting, that have materially affected, or are reasonable likely to materially affect, Mid Penn's internal control over financial reporting.

### **PART II OTHER INFORMATION**

#### **ITEM 1 LEGAL PROCEEDINGS**

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

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

There have been no material changes to the risk factors described in the Annual Report on Form 10-K for the year ended December 31, 2009.

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

None

**ITEM 3   DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4   (Removed and Reserved)**

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**MID PENN BANCORP, INC.**

**ITEM 5 OTHER INFORMATION**

None

**ITEM 6 EXHIBITS**

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

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

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

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

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

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

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

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

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**MID PENN BANCORP, INC.**

**SIGNATURES**

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

**Mid Penn Bancorp, Inc.**  
(Registrant)

By /s/ RORY G. RITRIEVI  
**Rory G. Ritrievi**  
**President and CEO**  
**(Principal Executive Officer)**

Date: August 9, 2010

By /s/ KEVIN W. LAUDENSLAGER  
**Kevin W. Laudenslager**  
**Treasurer**  
**(Principal Financial and Accounting Officer)**

Date: August 9, 2010