



**MID PENN BANCORP** INC.

*Making things happen for you.™*



A PROGRESSIVE, INDEPENDENT COMMUNITY BANK | 2004

annual**report**



# shareholderletter

Dear Shareholder:

I am pleased to present the 2004 Annual Report for Mid Penn Bancorp, Inc. Our Board of Directors and Staff are very excited to incorporate our energetic new logo and brand promise into the presentation of the Annual Report for you. We hope you are pleased with this progressive new format.

Our brand promise, "Making things happen for you," expresses our renewed commitment to finding ways to meet the financial needs of our customers in a timely, professional and innovative manner. By meeting the needs of our customers, we will continue to grow the Bank and enhance shareholder value.

We are excited about our growth opportunities in the Capital Region as we approach the opening of two new Harrisburg offices in 2005. We have also added equipment leasing to our product line, which will compliment our significant commercial banking portfolio. With our expansion, your Bank has made a conscious decision to plan for future growth by investing in new branches and staffing. We feel that longer term earnings will be positively impacted by the results of additional offices and equipment leasing services, but in the short-term, we expect that these activities will have a negative impact on earnings.

We experienced growth in total assets in 2004 of 8.0%, ending the year at approximately \$403,000,000. Loans of \$281,083,000 as of December 31, 2004, increased by \$47,456,000 or 20.3% from the prior year. The majority of loan growth was in commercial loans, resulting from the addition of seasoned commercial lenders to the Bank's staff, as well as improved loan demand. A significant portion of the loans added to the balance sheet were funded by a reduction in the investment portfolio, with the remainder funded by deposit growth and increased borrowings.

Net income of \$4,369,000 decreased by 5.3% from the prior year. This slight decrease was the first decrease in many years. A major factor affecting 2004 earnings was a required, larger than usual loan loss provision of \$725,000 in 2004, which compares to a \$290,000 provision in 2003. The need for the larger provision was attributable to the strong growth in the loan portfolio and a large commercial loan relationship that is performing, but was moved to a substandard classification because of additional risk recognized with this credit.

Mid Penn Bancorp, Inc.'s (MBP: AMEX) share price as of December 31, 2004 was \$27.80 compared to \$24.00 as of December 31, 2003, an increase of \$3.80 or 15.8%. A shareholder who purchased one share on December 31, 2003, would have received a regular dividend in 2004 of \$.80 plus a special dividend of \$1.00, for a dividend yield of 7.5%, and a total return, including market appreciation, of 23.3% as of December 31, 2004.

With so many new ventures and opportunities for us, I remain optimistic about the future for Mid Penn Bank. We have the good fortune to be expanding our footprint in a growing geographic market where bank mergers continue to provide numerous opportunities for a progressive community bank. We appreciate your continued support and confidence. I encourage you to contact me at (717) 692-2133 or e-mail me at [adakey@midpennbank.com](mailto:adakey@midpennbank.com) should you have any comments, suggestions or concerns. I certainly welcome your thoughts on our new Annual Report format, as well as our new logo and brand promise.

Sincerely,



Alan W. Dakey  
President and CEO



# annual<sup>2004</sup>report

Mid Penn Bancorp, Inc. is pleased to present a brand new look to the presentation and delivery of the Annual Report beginning with this, our 2004 Annual Report.

Separating and formatting the financial section as an excerpt is the most noticeable change. With shortened deadlines for banks to submit their 10-K financial data to the Securities and Exchange Commission, it has become necessary to be able to economically produce the financial data in a manner that allows for a quick, accurate reproduction. By segregating the financial data, we can concentrate on the overall presentation of the Annual Report, which we still feel is important, as the Annual Report is the primary opportunity that we have to communicate with you, our shareholders.

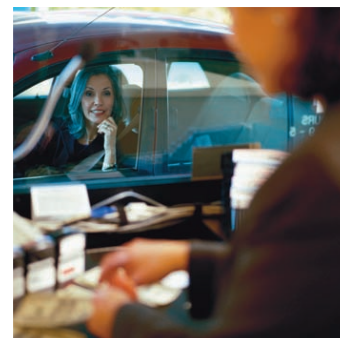
We hope that you agree that this revised format is a progressive, innovative new look for your Bank.

serving you **since 1868**

# BRAND new look THE SAME great service

While the look is brand new, you can be assured that you will continue to receive the same great service from Mid Penn Bank that our customers have become accustomed to receiving since 1868.

Mid Penn Bank's commitment to customers, both old and new, has never been stronger. Our employees are embracing the new look of our Bank, the renewed commitment to our customers and the promise to "Make things happen for you."



At the same time, Mid Penn Bank's Board of Directors and management are committed to remaining an independent, progressive community bank. We want to continue to grow with our customers and grow with the communities that we serve.

We truly believe that highly satisfied customers are the key to superior results, which bring rewards for our shareholders and our employees, as well as satisfaction in a job well done.

  
**MID PENN BANK**  
*Making things happen for you.<sup>SM</sup>*



Mid Penn Bank launched its new logo and brand promise as part of the Bank's recommitment to its customers to remain a progressive, independent community bank. In an era of mega-bank mergers and large bank monopolies, Mid Penn Bank is especially proud to have served its customers since 1868.

AT MID PENN BANK

## our people make **the difference**

Mid Penn Bank and our employees promise to work hard to meet the expectations of our brand promise - Making things happen for you. Through hard work and dedication, we continue to make things happen for our customers and our shareholders today, as we have since 1868.

At a time when most banks are changing their bank logos due to bank mergers, Mid Penn Bank continues to renew our commitment to our customers, to our community and to all those people who have supported us over the years. As we look forward to an exciting and rewarding future, Mid Penn Bank continues to challenge our employees to find ways to honor customer requests and be responsive to their financial needs by thinking "outside the box."

By applying innovative, unique philosophies to the decision-making process, we are able to keep our promise of "Making things happen for you."

  
**MID PENN BANK**  
*Making things happen for you.<sup>SM</sup>*

## retail**banking**

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At Mid Penn Bank, we strive to deliver an environment that is warm, friendly and unsurpassed in customer satisfaction. Our employees are accessible and attentive to your financial needs. We make every attempt to get to know you and your family so that we can make appropriate recommendations and suggestions, as well as share in your accomplishments and concerns during challenging times. Please know that we are here for you.

- Free Personal Checking
- Free Personal Checks
- Interest Checking
- Trust Services
- Alternative Investments
- Retirement Accounts
- Consumer Loans
- Mortgages
- On-Line Banking
- Check Card
- And Much More

# making things happen**for you**

## commercial**banking**

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Mid Penn Bank offers an extensive portfolio of products and services for all types of businesses.

With access to local decision makers, you receive prompt responses to loan requests from lenders who live and work in your community. We recognize that business opportunities require timely action, we understand your daily challenges, and are prepared to react to your immediate financial needs.

- Business Financing
- Real Estate Lending
- Local, Experienced Lenders
- Competitive Terms
- Equipment Leasing
- Title Insurance
- Sweep Accounts
- Free Business Checking
- Merchant Services
- Business On-Line Banking
- Business Check Card
- And Much More



FINANCIAL HIGHLIGHTS 2004  
**annualreport**

MID PENN BANCORP INC.

# financial **highlights**

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**AS OF AND FOR YEARS ENDED DECEMBER 31, 2004 AND 2003**

(Dollars in thousands, except per share data.)

	<u>2004</u>	<u>2003</u>	<u>Percent Change</u>
Total Assets .....	\$ 403,256	373,466	+7.98%
Total Deposits .....	301,144	288,338	+4.44%
Net Loans .....	275,904	229,086	+20.44%
Total Investments and Interest Bearing Balances.....	105,020	124,011	-15.31%
Stockholders' Equity .....	35,272	37,361	-5.59%
Net Income .....	4,369	4,615	-5.33%
Earnings Per Share .....	1.37	1.45	-5.52%
Cash Dividend Per Share .....	1.80	.80	+127.85%
Book Value Per Share.....	11.06	11.72	-5.63%
Return on Average Stockholders' Equity .....	12.73%	12.69%	+0.32%
Return on Average Assets .....	1.12%	1.25%	-10.40%
Net Interest Margin.....	3.48%	3.63%	-4.13%
Nonperforming Loans to Total Loans .....	0.63%	1.18%	-46.61%

Mid Penn Bancorp, Inc.  
Stockholders' Information

	<u>2004</u>		<u>2003</u>		<u>Quarter</u>
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	
Market Value Per Share .....	\$ 31.95	23.75	22.00	21.00	1st
	28.78	27.25	23.50	21.25	2nd
	31.25	27.20	24.25	21.10	3rd
	28.20	25.10	24.35	22.00	4th

Market Value Information: The market share information was provided by the American Stock Exchange, New York, NY. Mid Penn Bancorp, Inc. common stock trades on the American Stock Exchange under the symbol: MBP.

Transfer Agent: Wells Fargo Shareholder Services, P.O. Box 64854, St. Paul, MN 55164-0854.  
Phone: 1-800-468-9716.

Number of Stockholders: At December 31, 2004, there were 1,023 stockholders.

Dividends: A dividend of \$.20 per share was paid during each quarter of 2004 and 2003. A special dividend of \$1.00 per share was also paid in the first quarter of 2004. Mid Penn Bancorp, Inc. plans to continue a quarterly dividend payable in February, May, August and November.

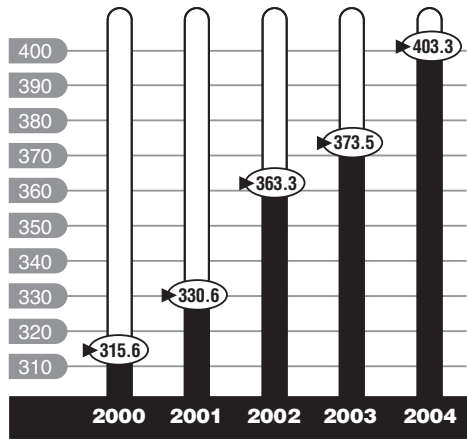
Dividend Reinvestment and Stock Purchases: Stockholders of Mid Penn Bancorp, Inc. may acquire additional shares of common stock by reinvesting their cash dividends under the Dividend Reinvestment Plan without paying a brokerage fee. Voluntary cash contributions may also be made under the Plan. For additional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

Form 10-K: A Copy of Mid Penn Bancorp, Inc.'s Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, will be provided to stockholders without charge upon written request to: Secretary, Mid Penn Bancorp, Inc., 349 Union Street, Millersburg, PA 17061.

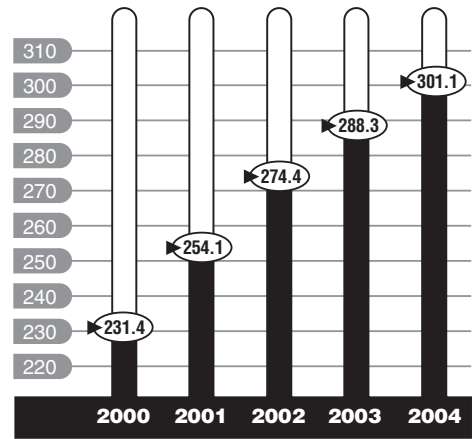
Annual Meeting: The Annual Meeting of the Stockholders of Mid Penn Bancorp, Inc. will be held at 10:00 a.m. on Tuesday, April 26, 2005, at 349 Union Street, Millersburg, Pennsylvania.

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

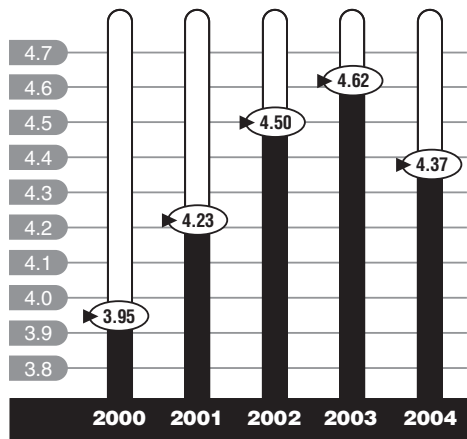
**TOTAL ASSETS (IN MILLIONS)**



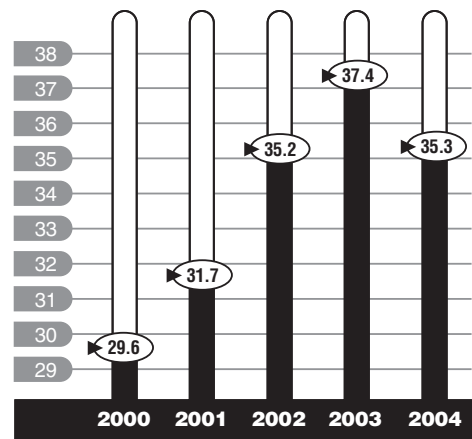
**TOTAL DEPOSITS (IN MILLIONS)**



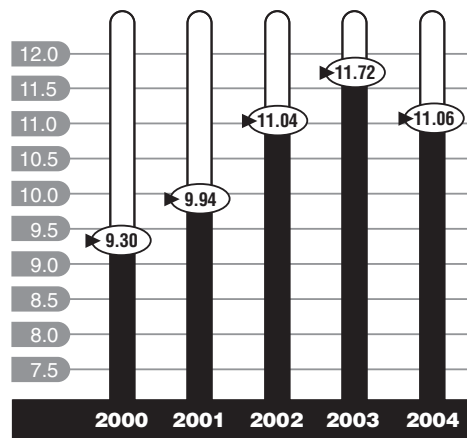
**NET INCOME (IN MILLIONS)**



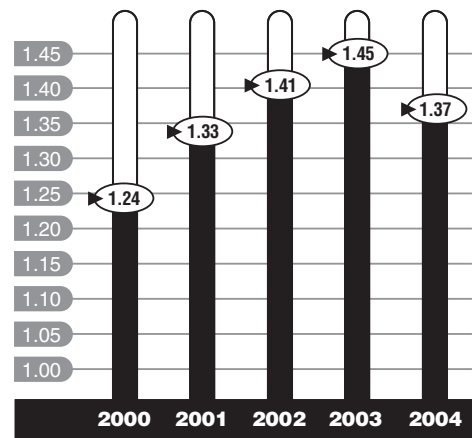
**TOTAL STOCKHOLDERS' EQUITY (IN MILLIONS)**



**BOOK VALUE PER SHARE (IN DOLLARS)**



**EARNINGS PER SHARE (IN DOLLARS)**



# PARENTE RANDOLPH

*The Power of Ideas*

The Board of Directors and Stockholders  
Mid Penn Bancorp, Inc.  
Millersburg, Pennsylvania:

We have audited the accompanying consolidated balance sheet of Mid Penn Bancorp, Inc. and subsidiaries (collectively, "Corporation") as of December 31, 2004 and 2003, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mid Penn Bancorp, Inc. and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the Standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 9, 2005 expressed an unqualified opinion on management's assesment of internal control over financial reporting and an adverse opinion on the effectiveness of internal control over financial reporting.



PARENTE RANDOLPH, LLC

Williamsport, Pennsylvania  
February 9, 2005

**DECEMBER 31, 2004 AND 2003**

(Dollars in thousands, except share data)	<u>2004</u>	<u>2003</u>
<b>ASSETS</b>		
Cash and due from banks .....	\$ 6,679	7,456
Interest-bearing balances with other financial institutions .....	60,407	69,918
Available-for-sale investment securities .....	44,613	54,093
Loans .....	281,083	233,627
Less:		
Unearned income .....	(1,536)	(1,549)
Allowance for loan losses .....	(3,643)	(2,992)
Net loans .....	<u>275,904</u>	<u>229,086</u>
Bank premises and equipment, net .....	4,874	3,920
Foreclosed assets held for sale .....	505	1,117
Accrued interest receivable .....	1,875	1,763
Deferred income taxes .....	982	303
Goodwill .....	259	0
Core deposit intangible .....	271	0
Cash surrender value of life insurance .....	6,180	4,953
Other assets .....	707	857
<b>Total Assets</b>	<b>\$ <u>403,256</u></b>	<b><u>373,466</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits:		
Noninterest-bearing demand .....	\$ 37,586	30,762
Interest-bearing demand .....	35,562	36,917
Money market .....	43,116	45,457
Savings .....	28,414	27,754
Time .....	<u>156,466</u>	<u>147,448</u>
<b>Total Deposits</b>	<b>301,144</b>	<b>288,338</b>
Short-term borrowings .....	13,801	9,688
Accrued interest payable .....	1,192	1,045
Other liabilities .....	1,890	1,350
Long-term debt .....	<u>49,957</u>	<u>35,684</u>
<b>Total Liabilities</b>	<b><u>367,984</u></b>	<b><u>336,105</u></b>
Stockholders' Equity:		
Common stock, par value \$1 per share; authorized 10,000,000 shares; 3,207,912 shares issued in 2004 and 2003 .....	3,208	3,208
Additional paid-in capital .....	23,472	23,472
Retained earnings .....	8,435	9,805
Accumulated other comprehensive income .....	693	1,415
Treasury stock at cost (19,086 and 19,408 shares in 2004 and 2003, respectively) .....	<u>(536)</u>	<u>(539)</u>
<b>Stockholders' Equity, Net</b>	<b><u>35,272</u></b>	<b><u>37,361</u></b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ <u>403,256</u></b>	<b><u>373,466</u></b>

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

**FOR YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002**

(Dollars in thousands, except share data)	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>INTEREST INCOME</b>			
Interest and fees on loans .....	\$ 16,327	15,470	15,863
Interest on interest-bearing balances.....	1,809	2,099	2,703
Interest and dividends on investment securities:			
U.S. Treasury and government agencies.....	599	559	659
State and political subdivision obligations, tax-exempt .....	1,286	1,783	2,001
Other securities .....	49	64	79
Interest on federal funds sold and securities purchased under agreement to resell .....	7	9	47
Total Interest Income	<u>20,077</u>	<u>19,984</u>	<u>21,352</u>
<b>INTEREST EXPENSE</b>			
Interest on deposits.....	5,624	6,117	7,807
Interest on short-term borrowings.....	137	128	50
Interest on long-term debt.....	2,244	2,189	2,069
Total Interest Expense	<u>8,005</u>	<u>8,434</u>	<u>9,926</u>
Net Interest Income	12,072	11,550	11,426
PROVISION FOR LOAN LOSSES .....	725	290	425
Net Interest Income After Provision for Loan Losses	<u>11,347</u>	<u>11,260</u>	<u>11,001</u>
<b>NONINTEREST INCOME</b>			
Trust department income .....	248	202	188
Service charges on deposits.....	1,467	1,227	1,053
Investment securities gains, net.....	475	261	60
Gain on sale of loans.....	0	45	51
Income on cash surrender value of life insurance .....	211	210	239
Fee income from investment services.....	162	21	67
Fee income from debit card transactions .....	169	149	146
Other income .....	725	592	218
Total Noninterest Income	<u>3,457</u>	<u>2,707</u>	<u>2,022</u>
<b>NONINTEREST EXPENSE</b>			
Salaries and employee benefits.....	4,918	4,496	3,978
Occupancy expense, net .....	456	423	384
Equipment expense.....	631	602	514
Pennsylvania bank shares tax expense .....	265	266	259
Legal and professional expense .....	385	284	160
Marketing and advertising .....	185	100	115
Debit card processing expense .....	214	167	207
Director fees and benefits expense .....	196	201	225
Other expenses.....	1,780	1,560	1,416
Total Noninterest Expense	<u>9,030</u>	<u>8,099</u>	<u>7,258</u>
INCOME BEFORE PROVISION FOR INCOME TAXES .....	5,774	5,868	5,765
Provision for income taxes .....	1,405	1,253	1,270
Net Income	<u>\$ 4,369</u>	<u>4,615</u>	<u>4,495</u>
Earnings Per Share	<u>\$ 1.37</u>	<u>1.45</u>	<u>1.41</u>
Weighted Average Number of Shares Outstanding	<u>3,188,867</u>	<u>3,188,504</u>	<u>3,188,333</u>

Earnings per share information has been restated to reflect the retroactive effect of a five percent stock dividend in the second quarter of 2003.

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

**FOR YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002**

(Dollars in thousands, except share data)

	Common	Additional	Retained	Accumulated Other Comprehensive	Treasury	Total
	Stock	Paid-in Capital	Earnings	Income (Loss)	Stock	
Balance, December 31, 2001.....	\$ 3,057	20,368	8,880	(56)	(533)	<u>31,716</u>
Comprehensive income:						
Net income.....	0	0	4,495	0	0	4,495
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects.....	0	0	0	1,413	0	<u>1,413</u>
Total comprehensive income						<u>5,908</u>
Cash dividends (\$ .80 per share, historical).....	0	0	(2,431)	0	0	(2,431)
Sale of treasury stock (443 shares).....	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>11</u>	<u>11</u>
Balance, December 31, 2002.....	3,057	20,368	10,944	1,357	(522)	<u>35,204</u>
Comprehensive income:						
Net income.....	0	0	4,615	0	0	4,615
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects.....	0	0	0	58	0	<u>58</u>
Total comprehensive income						<u>4,673</u>
Cash dividends (\$ .80 per share, historical).....	0	0	(2,499)	0	0	(2,499)
5% stock dividend (additional 151,411 shares).....	151	3,104	(3,255)	0	0	0
Purchase of treasury stock (786 shares).....	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(17)</u>	<u>(17)</u>
Balance, December 31, 2003.....	3,208	23,472	9,805	1,415	(539)	<u>37,361</u>
Comprehensive income:						
Net income.....	0	0	4,369	0	0	4,369
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects.....	0	0	0	(722)	0	<u>(722)</u>
Total comprehensive income						<u>3,647</u>
Cash dividends (\$1.80 per share, historical).....	0	0	(5,739)	0	0	(5,739)
Sale of treasury stock (322 shares).....	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>3</u>	<u>3</u>
Balance, December 31, 2004.....	<u>\$ 3,208</u>	<u>23,472</u>	<u>8,435</u>	<u>693</u>	<u>(536)</u>	<u>35,272</u>

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

**FOR YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002**

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Operating Activities:</b>			
Net income .....	\$ 4,369	4,615	4,495
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses.....	725	290	425
Depreciation .....	475	426	340
Amortization of core deposit intangible.....	20	0	0
Increase in cash surrender value of life insurance .....	(211)	(210)	(239)
Investment securities gains, net .....	(475)	(261)	(60)
(Gain) loss on sale of foreclosed assets .....	4	(20)	54
Gain on sale of loans .....	0	(45)	(51)
Deferred income taxes .....	(307)	123	(147)
Change in accrued interest receivable.....	(112)	244	84
Change in other assets.....	142	380	(712)
Change in accrued interest payable.....	147	(142)	(105)
Change in other liabilities.....	540	(301)	307
Net Cash Provided By Operating Activities	<u>5,317</u>	<u>5,099</u>	<u>4,391</u>
<b>Investing Activities:</b>			
Net decrease (increase) in interest-bearing balances .....	9,511	(4,431)	(12,445)
Proceeds from the maturity of investment securities.....	7,979	15,635	8,163
Proceeds from the sale of investment securities .....	17,195	5,793	3,176
Purchases of investment securities .....	(16,305)	(16,313)	(12,657)
Purchase of life insurance .....	(1,016)	0	0
Cash received from business combination.....	4,139	0	0
Proceeds from sale of loans .....	0	1,710	983
Net increase in loans.....	(45,163)	(13,530)	(19,969)
Purchases of bank premises and equipment.....	(1,429)	(1,029)	(262)
Proceeds from the sale of foreclosed assets .....	879	475	1,311
Capitalized additions - foreclosed assets.....	(147)	0	(163)
Net Cash Used In Investing Activities	<u>(24,357)</u>	<u>(11,690)</u>	<u>(31,863)</u>
<b>Financing Activities:</b>			
Net increase in deposits .....	5,613	13,635	20,598
Net (decrease) increase in short-term borrowings .....	4,113	(8,468)	8,546
Cash dividends paid.....	(5,739)	(2,499)	(2,431)
Long-term debt repayment.....	(5,127)	(5,199)	(185)
Sale (purchase) of treasury stock.....	3	(17)	11
Long-term borrowings.....	19,400	8,500	0
Net Cash Provided By Financing Activities	<u>18,263</u>	<u>5,952</u>	<u>26,539</u>
Net decrease in cash and due from banks.....	(777)	(639)	(933)
Cash and due from banks at January 1 .....	7,456	8,095	9,028
Cash and due from banks at December 31 .....	\$ <u>6,679</u>	<u>7,456</u>	<u>8,095</u>
<b>Supplemental Disclosures of Cash Flow Information:</b>			
Interest paid .....	\$ 7,858	8,576	10,031
Income taxes paid .....	\$ 1,385	1,410	1,427
<b>Supplemental Noncash Disclosures:</b>			
Loan charge-offs .....	\$ 74	349	230
Transfers to foreclosed assets held for sale .....	\$ 124	791	290
<b>Business Combination:</b>			
Fair value of assets acquired.....	\$ 3,054	0	0
Fair value of liabilities assumed.....	\$ 7,193	0	0

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

(1) Basis of Presentation

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

(2) Nature of Business

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

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

Mid Penn Investment Corporation is engaged in investing activities.

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

(3) Summary of Significant Accounting Policies

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

(a) Use of Estimates

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

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

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

(b) Investment Securities

Investments are accounted for as follows:

Available-for-Sale Securities - includes debt and restricted equity securities. Debt securities are reported at fair value, with unrealized holding gains and losses excluded from earnings and reported, net of deferred income taxes, as a component of accumulated other comprehensive income (loss) within stockholders’ equity. Realized gains and losses on sales of investment securities are computed on the basis of specific identification of the cost of each security. Restricted equity securities are generally carried at cost and evaluated for impairment due to the lack of available market data. Restricted equity securities for which market data is available are reported as fair value.

(c) Loans

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



(d) Allowance for Loan Losses

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

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

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

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

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

(e) Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is provided on the straight-line basis. Maintenance and repairs are charged to expense when incurred. Gains and losses on dispositions are reflected in current operations.

(f) Foreclosed Assets Held for Sale

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

(g) Income Taxes

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

(h) Core Deposit Intangible

Core deposit intangible is a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. In 2004, MPB acquired core deposit intangible in the amount of \$291,000 in connection with its purchase of assets and assumption of liabilities of the Dauphin office of Vartan National Bank. The core deposit intangible is being amortized over an 8 year life on a straight-line basis. The recoverability of the carrying value of intangible asset is evaluated on an ongoing basis, and permanent declines in value, if any, are charged to expense.

(i) Goodwill

Goodwill is the excess of the purchase price over the fair value of assets acquired in connection with business acquisitions accounted for as purchases. In 2004, MPB recorded goodwill of \$259,000 in connection with its purchase of assets and assumption of liabilities of the Dauphin office of Vartan National Bank. Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," requires a two-step process for testing the impairment of goodwill on at least an annual basis. Based on the fair value of the reporting unit, estimated using the expected present value of future cash flows, no impairment of goodwill was recognized in 2004. For Federal income tax reporting purposes, goodwill is expected to be amortized over 15 years.

(j) Marketing and Advertising Costs

Marketing and advertising costs are expensed as incurred and were \$185,000 in 2004, \$100,000 in 2003 and \$115,000 in 2002.

(k) Pensions and Other Postretirement Benefit Plans

Effective December 31, 2003, MPB adopted Statement of Financial Accounting Standards No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits" ("Revised SFAS No. 132"). Revised SFAS No. 132 requires additional disclosures about defined benefit pension plans and other postretirement defined benefit plans. It does not change the measurement or recognition of those plans. Applicable prior year disclosures have been restated to conform to Revised SFAS No. 132 requirements.

(l) Other Benefit Plan

A funded contributory profit-sharing plan is maintained for substantially all employees. The cost of the Bank's profit-sharing plan is charged to current operating expenses and is funded annually.

(m) Trust Assets and Income

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

(n) Earnings Per Share

Earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during each of the years presented giving retroactive effect to stock dividends and stock splits. MPB's basic and diluted earnings per share are the same since there are no potentially dilutive securities outstanding.

(o) Statement of Cash Flows

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

(p) Reclassifications

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

(4) Comprehensive Income

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

(Dollars in thousands)	Years Ended December 31,		
	2004	2003	2002
Unrealized holding (losses) gains on available-for-sale securities.....	\$ (619)	349	2,193
Less reclassification adjustment for gains realized in income .....	(475)	(261)	(60)
Net unrealized (losses) gains .....	(1,094)	88	2,133
Income tax benefit (expense) .....	372	(30)	(720)
Net .....	\$ (722)	58	1,413

(5) Restrictions on Cash and Due from Bank Accounts

The Bank is required to maintain reserve balances with the Federal Reserve Bank of Philadelphia. The amounts of those required reserve balances were \$575,000 at December 31, 2004 and \$549,000 at December 31, 2003.

Deposits with one financial institution are insured up to \$100,000. The Bank maintains cash and cash equivalents with certain financial institutions in excess of the insured amount.

(6) Investment Securities

At December 31, 2004 and 2003, amortized cost, fair value, and unrealized gains and losses on investment securities are as follows:

(Dollars in Thousands)	Amortized	Unrealized	Unrealized	Fair
December 31, 2004	Cost	Gains	Losses	Value
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies.....	\$ 11,998	12	91	11,919
Mortgage-backed U.S. government agencies.....	5,508	21	87	5,442
State and political subdivision obligations .....	22,621	1,213	13	23,821
Restricted equity securities.....	3,435	0	4	3,431
	\$ 43,561	1,246	195	44,613

(Dollars in Thousands)		Amortized	Unrealized	Unrealized	Fair
December 31, 2003		<u>Cost</u>	<u>Gains</u>	<u>Losses</u>	<u>Value</u>
Available-for-sale securities:					
U.S. Treasury and U.S.					
government agencies .....	\$	10,564	191	49	10,706
Mortgage-backed U.S.					
government agencies .....		4,808	64	31	4,841
State and political					
subdivision obligations .....		34,447	1,972	3	36,416
Restricted equity securities.....		<u>2,130</u>	<u>0</u>	<u>0</u>	<u>2,130</u>
	\$	<u>51,949</u>	<u>2,227</u>	<u>83</u>	<u>54,093</u>

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.

Restricted equity securities consist of stock in the Federal Home Loan Bank of Pittsburgh and Atlantic Central Bankers Bank which do not have a readily determinable fair value because their ownership is restricted and they lack a market. Also included in restricted 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 fulfill the Bank's regulatory requirement of the Community Reinvestment Act Investment and, at December 31, 2004, is reported at fair value net of an unrealized loss of \$4,000.

Investment securities having a fair value of \$29,128,000 at December 31, 2004 and \$26,803,000 at December 31, 2003, were pledged to secure public deposits and other borrowings.

Gains from sales of investment securities amounted to \$475,000 in 2004, \$261,000 in 2003 and \$60,000 in 2002. The proceeds from sales of investment securities were \$17,195,000 in 2004, \$5,793,000 in 2003 and \$3,176,000 in 2002.

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2004.

(In thousands)	Less Than 12 Months		12 Months or More		Total	
	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>
	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>
Available-for-sale securities:						
U.S. Treasury and U.S.						
government agencies .....	\$	0	0	7,906	91	7,906
Mortgage-backed U.S.						
government agencies .....		0	0	4,071	87	4,071
State and political						
subdivision obligations .....		0	0	716	13	716
Restricted equity securities .....		<u>0</u>	<u>0</u>	<u>246</u>	<u>4</u>	<u>246</u>
Total temporarily impaired available-for-sale securities ....	\$	<u>0</u>	<u>0</u>	<u>12,939</u>	<u>195</u>	<u>12,939</u>

The unrealized losses on investment securities are primarily the result of volatility in interest rates. Based on the credit worthiness of the issuers, management believes that investment securities at December 31, 2004 were not other-than-temporarily impaired.

The following is a schedule of the maturity distribution of investment securities at amortized cost and fair value at December 31, 2004 and 2003:

(Dollars in thousands)	December 31, 2004		December 31, 2003	
	Amortized	Fair	Amortized	Fair
	<u>Cost</u>	<u>Value</u>	<u>Cost</u>	<u>Value</u>
Due in 1 year or less .....	\$ 1,240	1,252	814	844
Due after 1 year but within 5 years.....	6,832	6,857	10,646	10,900
Due after 5 years but within 10 years.....	13,240	13,709	11,165	11,782
Due after 10 years.....	<u>13,306</u>	<u>13,922</u>	<u>22,386</u>	<u>23,596</u>
	34,618	35,740	45,011	47,122
Mortgage-backed securities .....	5,508	5,442	4,808	4,841
Restricted equity securities .....	<u>3,435</u>	<u>3,431</u>	<u>2,130</u>	<u>2,130</u>
	\$ <u>43,561</u>	<u>44,613</u>	<u>51,949</u>	<u>54,093</u>

(7) Loans

A summary of loans at December 31, 2004 and 2003 is as follows:

(Dollars in thousands)	<u>2004</u>	<u>2003</u>
Commercial real estate, construction and land development.....	\$ 195,549	154,296
Commercial, industrial and agricultural.....	30,940	25,567
Real estate - residential.....	43,914	43,384
Consumer.....	<u>10,680</u>	<u>10,380</u>
	\$ <u>281,083</u>	<u>233,627</u>

Net unamortized loan fees and costs of \$344,000 in 2004 and \$167,000 in 2003 were deducted from loans.

Loans and available credit to Bank executive officers, directors, and corporations in which such executive officers and directors have beneficial interests as stockholders, executive officers, or directors aggregated approximately \$2,983,000 at December 31, 2004 and \$3,275,000 at December 31, 2003. New loans extended were \$867,000 in 2004 and \$2,328,000 in 2003. Net payments on these loans equalled \$1,159,000 during 2004 and \$988,000 during 2003. These loans were made on substantially the same basis, including interest rates and collateral as those prevailing for comparable transactions with other borrowers at the same time.

(8) Allowance for Loan Losses

Changes in the allowance for loan losses for the years 2004, 2003, and 2002 are summarized as follows:

	(Dollars in thousands)		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Balance, January 1.....	\$ 2,992	3,051	2,856
Provision for loan losses.....	725	290	425
Loans charged off.....	(121)	(409)	(302)
Recoveries on loans charged off.....	<u>47</u>	<u>60</u>	<u>72</u>
Balance, December 31.....	\$ <u>3,643</u>	<u>2,992</u>	<u>3,051</u>

The recorded investment in loans that are considered impaired amounted to \$1,013,000 and \$439,000 on December 31, 2004 and December 31, 2003, respectively. By definition, impairment of a loan is considered when, based on current information and events, it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. The allowance for loan losses related to loans classified as impaired amounted to approximately \$126,000 at December 31, 2004 and \$40,000 at December 31, 2003. All impaired loans at the end of 2004 and 2003 had related allowances. The average balances of these loans amounted to approximately \$945,000, \$983,000 and \$1,361,000 for the years 2004, 2003 and 2002, respectively. The Bank recognizes interest income on impaired loans on a cash basis. The following is a summary of cash receipts on these loans and how they were applied in 2004, 2003 and 2002.

(Dollars in thousands)	<u>2004</u>	<u>2003</u>	<u>2002</u>
Cash receipts applied to reduce principal balance.....	\$ 36	4	122
Cash receipts recognized as interest income.....	<u>3</u>	<u>0</u>	<u>1</u>
Total cash receipts.....	\$ <u>39</u>	<u>4</u>	<u>123</u>

Loans which were past due 90 days or more for which interest continued to be accrued amounted to approximately \$394,000 at December 31, 2004 and \$661,000 at December 31, 2003. The Bank has no commitments to loan additional funds to borrowers with impaired or nonaccrual loans.

(9) Bank Premises and Equipment

At December 31, 2004 and 2003, bank premises and equipment are as follows:

(Dollars in thousands)	<u>2004</u>	<u>2003</u>
Land.....	\$ 1,288	838
Buildings.....	4,732	4,001
Furniture and fixtures.....	<u>4,966</u>	<u>4,720</u>
	10,986	9,559
Less accumulated depreciation.....	<u>6,112</u>	<u>5,639</u>
	\$ <u>4,874</u>	<u>3,920</u>

Depreciation expense was \$475,000 in 2004, \$426,000 in 2003 and \$340,000 in 2002.

(10) Deposits

At December 31, 2004 and 2003, time deposits in denominations of \$100,000 or more amounted to \$27,883,000 and \$24,598,000, respectively. Interest expense on such certificates of deposit amounted to approximately \$830,000, \$873,000, and \$1,112,000 for the years ended December 31, 2004, 2003 and 2002, respectively. Time deposits at December 31, 2004, mature as follows: (in thousands) 2005, \$57,216; 2006, \$33,376; 2007, \$37,993; 2008, \$12,720; 2009, \$13,007; thereafter, \$2,154.

Deposits and other funds from related parties held by MPB at December 31, 2004 and 2003 amounted to approximately \$6,133,000 and \$4,727,000, respectively.

(11) Short-term Borrowings

Short-term borrowings as of December 31, 2004 and 2003 consisted of:

(Dollars in thousands)	<u>2004</u>	<u>2003</u>
Federal funds purchased.....	\$ 10,400	6,000
Repurchase agreements .....	2,928	3,246
Treasury, tax and loan notes .....	473	254
Due to broker .....	0	188
	<u>\$ 13,801</u>	<u>9,688</u>

Federal funds purchased represent overnight funds. Securities sold under repurchase agreements generally mature between one day and one year. Treasury, tax and loan notes are open-ended interest bearing notes payable to the U.S. Treasury upon call. All tax deposits accepted by the Bank are placed in the Treasury note option account. The due to broker balance represents previous day balances transferred from deposit accounts under a sweep account agreement. The Bank also has unused lines of credit with several banks amounting to \$34,600,000 dollars at December 31, 2004.

(12) Long-term Debt

The Bank is a member of the Federal Home Loan Bank of Pittsburgh (FHLB) and through its membership, the Bank can access a number of credit products which are utilized to provide various forms of liquidity. As of December 31, 2004 and 2003, the Bank had long-term debt in the amount of \$49,957,000 and \$35,684,000, respectively, consisting of:

(Dollars in thousands)	At December 31	
	<u>2004</u>	<u>2003</u>
Loans matured in 2004 with rates ranging from 5.20% to 7.30% .....	\$ 0	5,087
Loans maturing in 2006 with rates ranging from 2.17% to 6.21% ....	10,000	5,000
Loans maturing in 2007 at a rate of 3.71% .....	5,000	0
Loans maturing in 2008 at a rate of 3.08% .....	5,000	5,000
Loans maturing in 2009 with rates ranging from 4.22% to 7.24% ....	12,000	7,000
Loans maturing in 2010 with rates ranging from 6.28% to 6.71% ....	10,000	10,000
Loans maturing in 2013 with rates ranging from 4.08% to 4.75% ....	3,500	3,500
Loans maturing in 2026 at a rate of 4.80% .....	4,362	0
Loans maturing in 2005 through 2027 at a rate of 6.71% .....	95	97
Total Long-term Debt	<u>\$ 49,957</u>	<u>35,684</u>

The aggregate amounts of maturities of long-term debt subsequent to December 31, 2004 are \$10,002,000 (2006), \$5,002,000 (2007), \$5,002,000 (2008), \$12,003,000 (2009), \$17,948,000 thereafter. Most of the Bank's investments and mortgage loans are pledged to secure FHLB borrowings.

(13) Pension and Other Postretirement Benefit Plans

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

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

The significant aspects of each plan are as follows:

(a) Health Insurance

For full-time employees who retire after at least 20 years of service, MPB will pay premiums for major medical insurance (as provided to active employees) for a period ending on the earlier of the date the participant obtains

other employment where major medical coverage is available or the date of the participant's death; however, in all cases payment of medical premiums by MPB will not exceed five years. If the retiree becomes eligible for Medicare within the five year period beginning on his/her retirement date, the Bank may pay, at its discretion, premiums for 65 Special coverage or a similar supplemental coverage. After the five year period has expired, all MPB paid benefits cease; however, the retiree may continue coverage through the Bank at his/her own expense.

(b) Life Insurance

For full-time employees who retire after at least 20 years of service, MPB will provide term life insurance. The amount of coverage prior to age 65 will be three times the participant's annual salary at retirement or \$50,000, whichever is less. After age 65, the life insurance coverage amount will decrease by 10% per year, subject to a minimum amount of \$2,000.

(c) Retirement Plan

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

The following tables provide a reconciliation of the changes in the plans' health and life insurance benefit obligations and fair value of plan assets for the years ended December 31, 2004 and 2003 and a statement of the funded status at December 31, 2004 and 2003:

(Dollars in thousands)	December 31,	
	<u>2004</u>	<u>2003</u>
Change in benefit obligations:		
Benefit obligations, January 1.....	\$ 501	450
Service cost .....	38	30
Interest cost.....	31	30
Actuarial loss.....	92	10
Benefit payments .....	(16)	(19)
Benefit obligations, December 31.....	<u>\$ 646</u>	<u>501</u>
Change in fair value of plan assets:		
Fair value of plan assets, January 1 .....	\$ 0	0
Employer contributions .....	16	19
Benefit payments .....	(16)	(19)
Fair value of plan assets, December 31 .....	<u>\$ 0</u>	<u>0</u>

(Dollars in thousands)	December 31,	
	<u>2004</u>	<u>2003</u>
Funded status:		
Excess of the benefit obligation over the value of plan assets.....	\$ (646)	(501)
Unrecognized transition obligation.....	117	133
Unrecognized loss (gain).....	4	(88)
Net amount recognized.....	<u>\$ (525)</u>	<u>(456)</u>

Amount recognized in the consolidated balance sheet at December 31, 2004 and 2003 is as follows:

(Dollars in thousands)	<u>2004</u>	<u>2003</u>
Accrued benefit liability .....	<u>\$ (525)</u>	<u>(456)</u>

The accumulated benefit obligation for health and life insurance plans was \$646,000 and \$501,000 at December 31, 2004 and 2003, respectively.

The components of net periodic postretirement benefit cost for 2004, 2003 and 2002 are as follows:

(Dollars in thousands)	<u>2004</u>	<u>2003</u>	<u>2002</u>
Service cost.....	\$ 38	30	24
Interest cost .....	31	30	28
Amortization of transition obligation.....	15	15	15
Amortization of net gain .....	0	(3)	(4)
Net periodic postretirement benefit cost .....	<u>\$ 84</u>	<u>72</u>	<u>63</u>

Assumptions used in the measurement of MPB's benefit obligations at December 31, 2004 and 2003 are as follows:

Weighted-average assumptions:	<u>2004</u>	<u>2003</u>
Discount rate.....	5.75%	6.00%
Rate of compensation increase.....	5.00%	5.00%

Assumptions used in the measurement of MPB's net periodic benefit cost for the years ended December 31, 2004, 2003 and 2002 are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Weighted-average assumptions:			
Discount rate.....	6.00%	6.75%	7.00%
Rate of compensation increase.....	5.00%	5.00%	5.00%

Assumed health care cost trend rates at at December 31, 2004, 2003 and 2002 are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Health care cost trend rate assumed for next year.....	10.00%	5.50%	6.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate).....	5.00%	5.50%	6.00%
Year that the rate reaches the ultimate trend rate.....	2009	2004	2003

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

	One-Percentage Point	
	<u>Increase</u>	<u>Decrease</u>
(Dollars in thousands)		
Effect on total of service and interest cost.....	\$ 11	9
Effect on postretirement benefit obligation.....	82	69

MPB expects to contribute \$21,154 to its postretirement benefit plans in 2005.

Estimated Future Benefit Payments

1/1/2005 to 12/31/2005.....	\$ 21,154
1/1/2006 to 12/31/2006.....	24,550
1/1/2007 to 12/31/2007.....	22,180
1/1/2008 to 12/31/2008.....	21,297
1/1/2009 to 12/31/2009.....	24,562
1/1/2010 to 12/31/2014.....	194,843

The following tables provide a reconciliation of the changes in the directors' defined benefit plan's benefit obligations and fair value of plan assets for the years ended December 31, 2004 and 2003 and a statement of the funded status at December 31, 2004 and 2003:

	December 31,	
	<u>2004</u>	<u>2003</u>
(Dollars in thousands)		
Change in benefit obligations:		
Benefit obligations, January 1.....	\$ 647	563
Service cost.....	22	20
Interest cost.....	39	37
Actuarial (gain) loss.....	5	(10)
Change in assumptions.....	17	46
Benefit payments.....	(18)	(9)
Benefit obligations, December 31.....	\$ <u>712</u>	<u>647</u>

(Dollars in thousands)

Change in fair value of plan assets:		<u>2004</u>	<u>2003</u>
Fair value of plan assets, January 1 .....	\$	0	0
Employer contributions .....		18	9
Benefit payments .....		<u>(18)</u>	<u>(9)</u>
Fair value of plan assets, December 31 .....	\$	<u>0</u>	<u>0</u>

(Dollars in thousands)

Funded status:		December 31,	
Excess of the benefit obligation over the value of plan assets .....	\$	(712)	(647)
Unrecognized prior-service cost .....		26	52
Unrecognized loss .....		57	35
Net amount recognized .....	\$	<u>(629)</u>	<u>(560)</u>

Amounts recognized in the consolidated balance sheet at December 31, 2004 and 2003 are as follows:

(Dollars in thousands)		<u>2004</u>	<u>2003</u>
Accrued benefit liability .....	\$	(645)	(573)
Intangible asset .....		16	13
Net amount recognized .....	\$	<u>(629)</u>	<u>(560)</u>

The accumulated benefit obligation for the retirement plan was \$645,000 and \$573,000 at December 31, 2004 and 2003, respectively.

Other plan information at December 31, 2004 and 2003 is as follows:

(Dollars in thousands)		<u>2004</u>	<u>2003</u>
Projected benefit obligation .....	\$	712	647
Accumulated benefit obligation .....		645	573
Fair value of plan assets .....		0	0

The components of net periodic pension cost for 2004, 2003 and 2002 are as follows:

(Dollars in thousands)		<u>2004</u>	<u>2003</u>	<u>2002</u>
Service cost .....	\$	22	20	23
Interest cost .....		39	37	35
Amortization of prior-service cost .....		26	26	26
Net periodic pension cost .....	\$	<u>87</u>	<u>83</u>	<u>84</u>

Assumptions used in the measurement of MPB's benefit obligations at December 31, 2004 and 2003 are as follows:

Weighted-average assumptions:		<u>2004</u>	<u>2003</u>
Discount rate .....		5.75%	6.00%
Change in consumer price index .....		4.00%	4.00%

Assumptions used in the measurement of MPB's net periodic benefit cost for the years ended December 31, 2004, 2003 and 2002 are as follows:

Weighted-average assumptions:		<u>2004</u>	<u>2003</u>	<u>2002</u>
Discount rate .....		6.00%	6.75%	7.00%
Rate of compensation increase .....		4.00%	4.00%	4.00%

MPB expects to contribute \$24,567 to its pension plan in 2005.

The Bank is the owner and beneficiary of insurance policies on the lives of certain officers and directors which informally fund the retirement plan obligation. The aggregate cash surrender value of these policies was \$2,244,000 and \$1,605,000 at December 31, 2004 and 2003, respectively.



## Estimated Future Benefit Payments

1/1/2005 to 12/31/2005 .....	\$	24,567
1/1/2006 to 12/31/2006 .....		48,828
1/1/2007 to 12/31/2007 .....		54,473
1/1/2008 to 12/31/2008 .....		61,150
1/1/2009 to 12/31/2009 .....		61,054
1/1/2010 to 12/31/2014 .....		331,865

(14) Other Benefit Plans(a) Profit-Sharing

The Bank has a funded contributory profit-sharing plan covering substantially all employees. The Bank's contribution to the plan was \$307,000 for 2004, \$267,000 for 2003 and \$235,000 for 2002.

(b) Deferred Compensation Plans

The Bank has an executive deferred compensation plan which allows an executive officer to defer bonus compensation for a specified period in order to provide future retirement income. At December 31, 2004 and 2003, the Bank has accrued a liability of approximately \$106,000 and \$82,000, respectively, for this plan.

The Bank also has a directors' deferred compensation plan which allows directors to defer receipt of monthly fees for a specified period in order to provide future retirement income. At December 31, 2004 and 2003, the Bank has accrued a liability of approximately \$179,000 and \$154,000, respectively, for this plan.

The Bank is the owner and beneficiary of insurance policies on the lives of the participating executive officer and directors which informally fund the benefit obligations. The aggregate cash surrender value of these policies was approximately \$1,626,000 and \$1,564,000 at December 31, 2004 and 2003, respectively.

(c) Salary Continuation Agreement

The Bank maintains a Salary Continuation Agreement (Agreement) for an executive officer. The Agreement provides the executive officer with a fixed annual benefit. The benefit is payable beginning at age 65 for a period of 15 years. If the executive officer terminates employment before the normal retirement date for reasons other than death, the annual benefit payable will be based on the vesting schedule as defined in the Agreement. Upon death or a change in control of the Bank, the executive officer or his beneficiary is entitled to the full fixed annual benefit. At December 31, 2004 and 2003, the Bank has accrued a liability of approximately \$161,000 and \$129,000, respectively, for the Agreement. The expense related to the Agreement was \$32,000 for 2004, \$30,000 for 2003 and \$28,000 for 2002.

The Bank is the owner and beneficiary of an insurance policy on the life of the participating executive officer which informally funds the benefit obligation. The aggregate cash surrender value of this policy was approximately \$866,000 and \$836,000 at December 31, 2004 and 2003, respectively.

(d) Employee Stock Ownership Plan

The Bank has an Employee Stock Ownership Plan (ESOP) covering substantially all employees. Contributions to the ESOP are made at the discretion of the Board of Directors. Total expense related to the Bank's contribution to the ESOP for 2004, 2003 and 2002 was \$155,000, \$134,000 and \$118,000, respectively. The ESOP held 32,836 and 27,941 shares of MPB stock as of December 31, 2004 and December 31, 2003, respectively, all of which were allocated to plan participants. Shares held by the ESOP are considered outstanding for purposes of calculating earnings per share. Dividends paid on shares held by the ESOP are charged to retained earnings.

(e) Other

At December 31, 2004 and 2003, the Bank had Split Dollar Life Insurance arrangements with two executives for which the aggregate collateral assignment and cash surrender values are approximately \$1,444,000 and \$948,000, respectively.

**(15) Federal Income Taxes**

The following temporary differences gave rise to the deferred tax asset at December 31, 2004 and 2003:

(Dollars in thousands)	<u>2004</u>	<u>2003</u>
Deferred tax assets:		
Allowance for loan losses .....	\$ 1,085	863
Benefit plans .....	555	460
Nonaccrual interest .....	54	37
Core deposit intangible .....	<u>3</u>	<u>0</u>
Total	\$ <u>1,697</u>	<u>1,360</u>

(Dollars in thousands)	<u>2004</u>	<u>2003</u>
Deferred tax liabilities:		
Depreciation .....	\$ (198)	(170)
Loan fees .....	(129)	(134)
Bond accretion .....	(20)	(24)
Other items .....	(11)	0
Unrealized gain on securities .....	<u>(357)</u>	<u>(729)</u>
Total	\$ <u>(715)</u>	<u>(1,057)</u>
Deferred tax asset, net .....	\$ <u>982</u>	<u>303</u>

The provision for income taxes consists of the following:

(Dollars in thousands)	<u>2004</u>	<u>2003</u>	<u>2002</u>
Current provision .....	\$ 1,712	1,130	1,417
Deferred provision .....	<u>(307)</u>	<u>123</u>	<u>(147)</u>
Provision for income taxes .....	\$ <u>1,405</u>	<u>1,253</u>	<u>1,270</u>

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

(Dollars in thousands)	<u>2004</u>	<u>2003</u>	<u>2002</u>
Provision at the expected statutory rate .....	\$ 1,963	1,995	1,960
Effect of tax-exempt income .....	(583)	(752)	(824)
Nondeductible interest .....	34	53	73
Other items .....	<u>(9)</u>	<u>(43)</u>	<u>61</u>
Provision for income taxes .....	\$ <u>1,405</u>	<u>1,253</u>	<u>1,270</u>

**(16) Business Combination**

On June 14, 2004, MPB consummated the purchase of assets and assumption of liabilities of the Dauphin office of Vartan National Bank ("Vartan"). MPB approved this deal in order to increase market share in the Central Pennsylvania Area. The net receipt of cash from Vartan was \$4,139,000. The results of operations of Vartan from the date of acquisition have been included in the accompanying consolidated financial statements.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

(Dollars in thousands)	<u>2004</u>
Cash .....	\$ 21
Loans .....	2,483
Goodwill .....	259
Core deposit intangible .....	<u>291</u>
Total Assets Acquired .....	\$ <u>3,054</u>
Deposits:	
Demand and savings deposits .....	\$ 4,297
Time .....	<u>2,896</u>
Total Liabilities Assumed .....	<u>7,193</u>
Net Liabilities Assumed .....	\$ <u>4,139</u>

Presented herein is certain unaudited pro forma information for 2004 as if Vartan had been acquired on January 1, 2004 and for 2003 as if Vartan had been acquired on January 1, 2003. These results combine historical results of Vartan into MPB's consolidated statement of income and, while certain adjustments were made for the estimated impact of purchase accounting adjustments and other acquisition-related activity, they are not necessarily indicative of what would have occurred had the acquisition taken place on the indicated dates.

(Dollars in thousands, except per share data)	Unaudited Pro forma for Year Ended December 31	
	<u>2004</u>	<u>2003</u>
Interest income .....	\$ 20,178	20,186
Noninterest income .....	3,482	2,757
Net income .....	4,428	4,733
Earnings per share .....	1.39	1.48

(17) Core Deposit Intangible

A summary of core deposit intangible is as follows at December 31, 2004.

(Dollars in thousands)	
Gross carrying amount .....	\$ 291
Less accumulated amortization .....	<u>20</u>
Net carrying amount	\$ <u>271</u>

Amortization expense amounted to \$20,000 in 2004.

The estimated amortization expense of intangible assets for each of the five succeeding fiscal years is \$36,000 per year.

(18) Regulatory Matters

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

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

(Dollars in thousands)	<u>Capital Adequacy</u>				To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	<u>Actual:</u>		<u>Minimum Capital Required:</u>		<u>Action Provisions:</u>	
As of December 31, 2004:	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Tier I Capital (to Average Assets) .....	\$ 27,346	7.0%	15,604	4.0%	19,505	5.0%
Tier I Capital (to Risk Weighted Assets) .....	27,346	9.0%	12,147	4.0%	18,221	6.0%
Total Capital (to Risk Weighted Assets) .....	30,989	10.2%	24,294	8.0%	30,368	10.0%
As of December 31, 2003:						
Tier I Capital (to Average Assets) .....	\$ 27,331	7.5%	14,565	4.0%	18,206	5.0%
Tier I Capital (to Risk Weighted Assets) .....	27,331	10.6%	10,301	4.0%	15,452	6.0%
Total Capital (to Risk Weighted Assets) .....	30,323	11.8%	20,602	8.0%	25,753	10.0%

As of December 31, 2004, the Bank's capital ratios are in excess of the minimum and well-capitalized guidelines and MPB's capital ratios are in excess of the Bank's capital ratios.

(19) Concentration of Risk and Off-Balance Sheet Risk

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

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

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

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

As of December 31, 2004, commitments to extend credit amounted to \$61,028,000 and financial standby letters of credit amounted to \$11,904,000.

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

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

As of December 31, 2004, commercial real estate financing was the only similar activity that met the requirements to be classified as a significant concentration of credit risk. However, there is a geographical concentration in that most of the Bank's business activity is with customers located in Central Pennsylvania, specifically within the Bank's trading area made up of Dauphin County, lower Northumberland County, western Schuylkill County and Hampden Township in Cumberland County.

The Bank's highest concentrations of credit are in the areas of hotel/motel lodging financings and apartment building financing. Outstanding credit to these sectors amounted to \$26,664,000 or 9.7% and \$24,276,000 or 8.8%, respectively, of net loans outstanding as of December 31, 2004.

(20) Commitments and Contingencies

Operating Lease

MPB has entered into a non-cancelable operating lease agreement to lease approximately 2,500 square feet of office space in the downtown Harrisburg area beginning in April 2005 with the initial term extending through March 2010. MPB has the option to renew this lease for two additional five year periods.

Minimum future rental payments under this operating lease as of December 31, 2004 for each of the next 5 years and in the aggregate are:

2005 .....	\$ 49,590
2006 .....	67,608
2007 .....	69,636
2008 .....	71,725
2009 .....	73,877
Thereafter .....	<u>18,605</u>
	\$ <u>351,042</u>

#### Litigation

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

#### (21) Parent Company Statements

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

#### CONDENSED BALANCE SHEET

December 31, 2004 and 2003

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
<b>ASSETS</b>		
Cash.....	\$ 273	279
Investment in Subsidiaries .....	<u>34,999</u>	<u>37,082</u>
Total Assets	\$ <u>35,272</u>	<u>37,361</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
	<u>2004</u>	<u>2003</u>
Stockholders' Equity .....	\$ 35,808	37,900
Less Treasury Stock.....	<u>(536)</u>	<u>(539)</u>
Total Liabilities and Equity	\$ <u>35,272</u>	<u>37,361</u>

#### CONDENSED STATEMENT OF INCOME

For Years Ended December 31, 2004, 2003 and 2002

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Dividends from Subsidiaries .....	\$ 5,774	2,566	2,496
Other Income from Subsidiaries .....	23	24	27
Undistributed Earnings of Subsidiaries.....	(1,361)	2,097	2,051
Other Expenses .....	<u>(67)</u>	<u>(72)</u>	<u>(79)</u>
Net Income	\$ <u>4,369</u>	<u>4,615</u>	<u>4,495</u>

#### CONDENSED STATEMENT OF CASH FLOWS

For Years Ended December 31, 2004, 2003 and 2002

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net Income .....	\$ 4,369	4,615	4,495
Undistributed Earnings of Subsidiaries.....	<u>1,361</u>	<u>(2,097)</u>	<u>(2,051)</u>
Net Cash Provided By Operating Activities	<u>5,730</u>	<u>2,518</u>	<u>2,444</u>

## CASH FLOWS FROM FINANCING ACTIVITIES

Dividends Paid .....	(5,739)	(2,499)	(2,431)
Sale (Purchase) of Treasury Stock.....	<u>3</u>	<u>(17)</u>	<u>11</u>
Net Cash Used In Financing Activities	(5,736)	(2,516)	(2,420)
Net (Decrease) Increase in Cash .....	(6)	2	24
Cash at Beginning of Period.....	<u>279</u>	<u>277</u>	<u>253</u>
Cash at End of Period .....	<u>\$ 273</u>	<u>279</u>	<u>277</u>

(22) Fair Value of Financial Instruments

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

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

## Cash and due from banks:

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

## Interest-bearing balances with other financial institutions:

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

## Investment securities:

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

## Loans:

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

## Deposits:

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

## Short-term borrowings:

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

## Long-term debt:

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

## Accrued interest:

The carrying amounts of accrued interest approximates their fair values.

## Off-balance sheet financial instruments:

There are no unearned fees outstanding on off-balance sheet financial instruments and the fair values are determined to be equal to the contractual values.

The following table summarizes the book value and fair value of financial instruments at December 31, 2004 and 2003.

(Dollars in thousands)	December 31, 2004		December 31, 2003	
	Book	Fair	Book	Fair
Financial assets:	<u>Value</u>	<u>Value</u>	<u>Value</u>	<u>Value</u>
Cash and due from banks.....	\$ 6,679	6,679	7,456	7,456
Interest-bearing balances .....	60,407	60,407	69,918	69,918
Investment securities.....	44,613	44,613	54,093	54,093
Net loans.....	275,904	283,141	229,086	239,812
(Dollars in thousands)	December 31, 2004		December 31, 2003	
Financial liabilities:	<u>Value</u>	<u>Value</u>	<u>Value</u>	<u>Value</u>
Deposits.....	\$ 301,144	302,517	288,338	292,206
Short-term borrowings .....	13,801	13,801	9,688	9,688
Accrued interest .....	1,192	1,192	1,045	1,045
Long-term debt .....	49,957	53,081	35,684	38,321
Off-balance sheet financial instruments:				
Commitments to extend credit.....	\$ 61,028	61,028	48,786	48,786
Financial standby letters of credit.....	11,904	11,904	5,804	5,804

(23) Common Stock:

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

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

(24) Summary of Quarterly Consolidated Financial Data (Unaudited):

The following table presents summarized quarterly financial data for 2004, 2003 and 2002.

(Dollars in Thousands, Except Per Share Data)	2004 Quarter Ended			
	<u>Mar. 31</u>	<u>June 30</u>	<u>Sept. 30</u>	<u>Dec. 31</u>
Interest Income .....	\$ 4,736	4,929	5,177	5,235
Interest Expense .....	1,927	1,885	2,021	2,172
Net Interest Income .....	2,809	3,044	3,156	3,063
Provision for Loan Losses .....	0	425	200	100
Net Interest Income After Provision for Loan Losses.....	2,809	2,619	2,956	2,963
Other Income .....	681	688	742	871
Securities Gains .....	202	234	39	0
Gain on Sale of Loans .....	0	0	0	0
Other Expenses.....	2,277	2,251	2,331	2,171
Income Before Income Tax Provision .....	1,415	1,290	1,406	1,663
Income Tax Provision.....	329	317	349	410
Net Income .....	\$ 1,086	973	1,057	1,253
Earnings Per Share .....	\$ 0.34	0.30	0.33	0.40

(Dollars in Thousands, Except Per Share Data)

	2003 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
Interest Income.....	\$ 5,139	5,089	4,902	4,854
Interest Expense.....	2,281	2,108	2,034	2,011
Net Interest Income .....	2,858	2,981	2,868	2,843
Provision for Loan Losses.....	190	25	75	0
Net Interest Income After Provision for Loan Losses .....	2,668	2,956	2,793	2,843
Other Income.....	598	570	585	648
Securities Gains.....	0	170	88	3
Gain on Sale of Loans .....	0	0	0	45
Other Expenses .....	1,948	2,025	2,077	2,049
Income Before Income Tax Provision.....	1,318	1,671	1,389	1,490
Income Tax Provision .....	266	404	303	280
Net Income.....	\$ 1,052	1,267	1,086	1,210
Earnings Per Share.....	\$ 0.33	0.40	0.34	0.38

(Dollars in Thousands, Except Per Share Data)

	2002 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
Interest Income .....	\$ 5,420	5,274	5,379	5,279
Interest Expense .....	2,511	2,483	2,550	2,382
Net Interest Income.....	2,909	2,791	2,829	2,897
Provision for Loan Losses .....	100	100	100	125
Net Interest Income After Provision for Loan Losses.....	2,809	2,691	2,729	2,772
Other Income .....	462	454	498	497
Securities Gains .....	5	0	55	0
Gain on Sale of Loans.....	0	0	0	51
Other Expenses.....	1,843	1,910	1,807	1,698
Income Before Income Tax Provision .....	1,433	1,235	1,475	1,622
Income Tax Provision.....	327	259	330	354
Net Income .....	\$ 1,106	976	1,145	1,268
Earnings Per Share .....	\$ 0.34	0.30	0.36	0.41

**(25) Recent Accounting Pronouncements:**

In March 2004, the FASB issued Emerging Issues Task Force (EITF) Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. This statement provides guidance for evaluating whether an investment is other-than-temporarily impaired and was effective for the other-than-temporary impairment evaluations made in the reporting periods beginning after June 15, 2004. The FASB staff has issued a proposed Board-directed FASB Staff Position, FSP EITF Issue 03-1-a, Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1. The proposed FSP would provide implementation guidance with respect to debt securities that are impaired solely due to interest rates and/or sector spreads and analyzed for other-than-temporary impairment under paragraph 16 of Issue 03-1. In September 2004, based on comment letters received by constituents, the Board decided to further consider whether application guidance is necessary for all securities analyzed for impairment under paragraphs 10-20 of Issue 03-1. The delay did not include the disclosure provisions which will remain in effect until the full reconsideration of Issue 03-1 guidance is completed. MPB will delay the effective application until the implementation guidance is finalized.

In December 2004, the FASB issued SFAS 123R which replaces SFAS 123, Accounting for Stock-Based Compensation, and supercedes APB Opinion 25, Accounting for Stock Issued to Employees. SFAS 123R requires that the cost of share-based payment transactions (including those with employees and nonemployees) be recognized in the financial statements. SFAS 123R applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share options, or other equity instruments (except for those held by an ESOP) or by incurring liabilities (1) in amounts based (even in part) on the price of the entity's shares or other equity instruments, or (2) that require (or may require) settlement by the issuance of an entity's shares or other equity instruments.

Public entities such as MPB are not required to apply SFAS 123R until the beginning of the first interim period or fiscal year beginning after June 15, 2005.



The purpose of this discussion is to further detail the financial condition and results of operations of Mid Penn Bancorp, Inc. (MPB). MPB is not aware of any known trends, events, uncertainties or of any current recommendations by the regulatory authorities which, if they were to be implemented, would have a material effect on MPB's liquidity, capital resources or operations. This discussion should be read along with the consolidated financial statements also appearing in this report.

### **Financial Summary**

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

MPB earned net income of \$4,369,000 for the year 2004, compared to \$4,615,000 in 2003, which was a decrease of \$246,000 or 5.3%. This represents net income in 2004 of \$1.37 per share compared to \$1.45 per share in 2003 and \$1.41 per share in 2002. The major reason for the decrease in earnings was the large provision for possible loan losses of \$725,000, compared to \$290,000 in 2003. The larger provision was needed because of the strong growth in the loan portfolio as well as the reclassification of a \$3.5 million loan as substandard.

Total assets of MPB continued to grow in 2004, reaching the level of \$403,256,000, an increase of \$29,790,000 or 8.0% over \$373,466,000 at year end 2003. The majority of growth came from increases in commercial real estate loans in the Capital Region. These increases were funded primarily through retained earnings of the Bank as well as proceeds from sales and maturities of bank investments, along with increased short-term and long-term borrowings.

MPB continued to achieve a solid return on average shareholders' equity, (ROE), a widely recognized performance indicator in the financial industry. The ROE was 12.03% in 2004, 12.69% in 2003 and 13.60% in 2002. Return on average assets (ROA), another performance indicator, was 1.12% in 2004, 1.25% in 2003 and 1.32% in 2002.

Tier one capital (to risk weighted assets) of \$27,346,000 or 9.0% and total capital (to risk weighted assets) of \$30,989,000 or 10.2% at December 31, 2004, are above the December 31, 2004 requirement, which is 4% for tier one capital and 8% for total capital. Tier one capital consists primarily of the bank's stockholders' equity. Total capital includes qualifying subordinated debt, if any, and the allowance for loan losses, within permitted limits. Risk-weighted assets are determined by assigning various levels of risk to different categories of assets and off-balance sheet activities.

### **Critical Accounting Policies**

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

### **Net Interest Income**

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

During 2004 net interest income increased \$522,000 or 4.5% as compared to an increase of \$124,000 or 1.1% in 2003. The average balances, effective interest differential and interest yields for the years ended December 31, 2004, 2003 and 2002 and the components of net interest income, are presented in Table 1. A comparative presentation of the changes in net interest income for 2004 compared to 2003, and 2003 compared to 2002, is given in Table 2. This analysis indicates the changes in interest income and interest expense caused by the volume and rate components of interest earning assets and interest bearing liabilities.

The yield on earning assets decreased to 5.66% in 2004 from 6.08% in 2003. The yield on earning assets for 2002 was 7.00%. The change in the yield on earning assets was due primarily to the downward movement of rates on new and maturing assets. The average "prime rate" for 2004 was 4.34% as compared to 4.12% for 2003 and 4.67% for 2002.

Interest expense decreased by \$429,000 or 5.1% in 2004 as compared to a decrease of \$1,492,000 or 15.0% in 2003. In order to maintain the spread between interest earning assets and interest bearing liabilities, management was forced to aggressively decrease the expense on deposits.

Primarily resulting from the fluctuations in interest rates, the net interest margin, on a tax equivalent basis, in 2004 was 3.48% compared to 3.63% in 2003 and 3.91% in 2002. Management continues to closely monitor the net interest margin.

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

INCOME AND RATES ON A TAXABLE EQUIVALENT BASIS  
FOR YEAR ENDED DECEMBER 31, 2004

(Dollars in thousands)	Average <u>Balance</u>	Interest <u>Income/Expense</u>	Average Rates <u>Earned/Paid</u>
<b>ASSETS:</b>			
Interest Bearing Balances .....	\$ 66,750	1,809	2.71%
Investment Securities:			
Taxable.....	17,531	599	3.42%
Tax-Exempt.....	<u>26,555</u>	1,948	7.34%
Total Investment Securities	<u>44,086</u>		
Federal Funds Sold.....	346	7	2.02%
Loans, Net .....	<u>256,627</u>	<u>16,449</u>	6.41%
Total Earning Assets .....	367,809	<u>20,812</u>	5.66%
Cash and Due from Banks .....	6,527		
Other Assets .....	<u>16,002</u>		
Total Assets	\$ <u>390,338</u>		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY:</b>			
Interest Bearing Deposits:			
NOW .....	\$ 34,750	61	0.18%
Money Market .....	45,202	442	0.98%
Savings .....	29,027	77	0.27%
Time .....	153,100	5,044	3.29%
Short-term Borrowings .....	11,415	137	1.20%
Long-term Debt.....	<u>43,780</u>	<u>2,244</u>	5.13%
Total Interest Bearing Liabilities .....	317,274	<u>8,005</u>	2.52%
Demand Deposits .....	37,586		
Other Liabilities.....	1,951		
Stockholders' Equity .....	<u>33,527</u>		
Total Liabilities and Stockholders' Equity	\$ <u>390,338</u>		
Net Interest Income .....	\$	<u>12,807</u>	
<b>Net Yield on Interest Earning Assets:</b>			
Total Yield on Earning Assets.....			5.66%
Rate on Supporting Liabilities .....			2.18%
Net Interest Margin .....			3.48%

**TABLE 1: AVERAGE BALANCES, EFFECTIVE INTEREST DIFFERENTIAL AND INTEREST YIELDS (cont'd)**

INCOME AND RATES ON A TAXABLE EQUIVALENT BASIS  
FOR YEAR ENDED DECEMBER 31, 2003

(Dollars in thousands)

	Average Balance	Interest Income/Expense	Average Rates Earned/Paid
<b>ASSETS:</b>			
Interest Bearing Balances .....	\$ 68,256	2,099	3.08%
Investment Securities:			
Taxable.....	14,222	559	3.93%
Tax-Exempt.....	36,355	2,702	7.43%
Total Investment Securities	<u>50,577</u>		
Federal Funds Sold.....	950	9	0.95%
Loans, Net .....	224,993	15,598	6.93%
Total Earning Assets .....	344,776	<u>20,967</u>	6.08%
Cash and Due from Banks .....	6,306		
Other Assets .....	17,489		
Total Assets	\$ <u>368,571</u>		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY:</b>			
Interest Bearing Deposits:			
NOW .....	\$ 33,897	82	0.24%
Money Market .....	45,072	638	1.42%
Savings .....	27,756	165	0.59%
Time .....	144,194	5,232	3.63%
Short-term Borrowings.....	10,670	128	1.20%
Long-term Debt.....	36,463	2,189	6.00%
Total Interest Bearing Liabilities .....	298,052	<u>8,434</u>	2.83%
Demand Deposits .....	30,918		
Other Liabilities.....	4,309		
Stockholders' Equity.....	<u>35,292</u>		
Total Liabilities and Stockholders' Equity	\$ <u>368,571</u>		
Net Interest Income .....	\$	<u>12,533</u>	
Net Yield on Interest Earning Assets:			
Total Yield on Earning Assets.....			6.08%
Rate on Supporting Liabilities.....			2.45%
Net Interest Margin .....			3.63%

**TABLE 1: AVERAGE BALANCES, EFFECTIVE INTEREST DIFFERENTIAL AND INTEREST YIELDS (cont'd)**

INCOME AND RATES ON A TAXABLE EQUIVALENT BASIS  
FOR YEAR ENDED DECEMBER 31, 2002

(Dollars in thousands)

	Average <u>Balance</u>	Interest <u>Income/Expense</u>	Average Rates <u>Earned/Paid</u>
<b>ASSETS:</b>			
Interest Bearing Balances .....	\$ 57,454	2,703	4.70%
Investment Securities:			
Taxable.....	14,460	738	5.10%
Tax-Exempt.....	<u>39,937</u>	3,032	7.59%
Total Investment Securities	<u>54,397</u>		
Federal Funds Sold.....	2,786	47	1.69%
Loans, Net .....	<u>207,028</u>	<u>15,983</u>	7.72%
Total Earning Assets .....	321,665	<u>22,503</u>	7.00%
Cash and Due from Banks .....	6,350		
Other Assets .....	<u>13,745</u>		
Total Assets	\$ <u>341,760</u>		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY:</b>			
Interest Bearing Deposits:			
NOW .....	\$ 32,480	168	0.52%
Money Market.....	36,390	801	2.20%
Savings .....	26,662	355	1.33%
Time .....	144,353	6,483	4.49%
Short-term Borrowings .....	4,821	50	1.04%
Long-term Debt.....	<u>32,469</u>	<u>2,069</u>	6.37%
Total Interest Bearing Liabilities .....	277,175	<u>9,926</u>	3.58%
Demand Deposits .....	28,069		
Other Liabilities.....	3,475		
Stockholders' Equity .....	<u>33,041</u>		
Total Liabilities and Stockholders' Equity	\$ <u>341,760</u>		
Net Interest Income .....	\$	<u>12,577</u>	
Net Yield on Interest Earning Assets:			
Total Yield on Earning Assets.....			7.00%
Rate on Supporting Liabilities .....			3.09%
Net Interest Margin .....			3.91%

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

Loan fees of \$448,000, 612,000 and \$550,000 are included with interest income in Table 1 for the years 2004, 2003 and 2002, respectively.

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

(Dollars in thousands)

	2004 Compared to 2003			2003 Compared to 2002		
	Increase (Decrease) Due to Change In:			Increase (Decrease) Due to Change In:		
<i>Taxable Equivalent Basis</i>	<u>Volume</u>	<u>Rate</u>	<u>Net</u>	<u>Volume</u>	<u>Rate</u>	<u>Net</u>
<b>INTEREST INCOME:</b>						
Interest Bearing Balances .....	\$ (46)	(244)	(290)	508	(1,112)	(604)
Investment Securities:						
Taxable.....	130	(90)	40	(12)	(167)	(179)
Tax-Exempt.....	<u>(719)</u>	<u>(35)</u>	<u>(754)</u>	<u>(272)</u>	<u>(58)</u>	<u>(330)</u>
Total Investment Securities	(635)	(369)	(714)	(284)	(225)	(509)
Federal Funds Sold.....	(6)	4	(2)	(31)	(7)	(38)
Loans, Net .....	<u>2,192</u>	<u>(1,341)</u>	<u>851</u>	<u>1,387</u>	<u>(1,772)</u>	<u>(385)</u>
Total Interest Income	<u>1,551</u>	<u>(1,706)</u>	<u>(155)</u>	<u>1,580</u>	<u>(3,116)</u>	<u>(1,536)</u>
<b>INTEREST EXPENSE:</b>						
Interest Bearing Deposits:						
NOW .....	2	(23)	(21)	7	(93)	(86)
Money Market .....	2	(198)	(196)	191	(354)	(163)
Savings .....	7	(95)	(88)	15	(205)	(190)
Time.....	<u>323</u>	<u>(511)</u>	<u>(188)</u>	<u>(7)</u>	<u>(1,244)</u>	<u>(1,251)</u>
Total Interest Bearing Deposits	334	(827)	(493)	206	(1,896)	(1,690)
Short-term Borrowings .....	9	0	9	61	17	78
Long-term Debt.....	<u>439</u>	<u>(384)</u>	<u>55</u>	<u>254</u>	<u>(134)</u>	<u>120</u>
Total Interest Expense	<u>782</u>	<u>(1,211)</u>	<u>(429)</u>	<u>521</u>	<u>(2,013)</u>	<u>(1,492)</u>
NET INTEREST INCOME .....	\$ <u>769</u>	<u>(495)</u>	<u>274</u>	<u>1,059</u>	<u>(1,103)</u>	<u>(44)</u>

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

### **Provision for Loan Losses**

The provision for loan losses charged to operating expense represents the amount deemed appropriate by management to maintain an adequate allowance for possible loan losses. Following its model for loan loss allowance adequacy, management made a \$725,000 provision in 2004 as well as a provision of \$290,000 in 2003 and \$425,000 in 2002. The allowance for loan losses as a percentage of average total loans was 1.42% at December 31, 2004, compared to 1.33% at December 31, 2003 and 1.45% at December 31, 2002, which continues to be higher than that of peer financial institutions due to MPB's higher level of loans to finance commercial real estate. The higher 2004 provision was due to both the more than 20% growth in loans during the year, coupled with the reclassification of a large commercial loan relationship to a substandard classification by the Bank's regulators. A summary of charge-offs and recoveries of loans is presented in Table 3.

**TABLE 3: ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES**

(Dollars in thousands)

	Years ended December 31,				
	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Balance, beginning of year .....	\$ 2,992	3,051	2,856	2,815	2,505
Loans charged-off:					
Commercial real estate, construction and land development .....	25	171	41	249	1
Commercial, industrial and agricultural .....	10	140	113	118	12
Real estate-residential .....	8	0	0	0	0
Consumer .....	78	98	148	122	61
Total loans charged off	<u>121</u>	<u>409</u>	<u>302</u>	<u>489</u>	<u>74</u>
Recoveries on loans previously charged-off:					
Commercial real estate, construction and land development .....	0	0	17	0	28
Commercial, industrial and agricultural .....	8	14	0	1	5
Real estate-residential .....	0	0	0	0	0
Consumer .....	39	46	55	29	26
Total recoveries	<u>47</u>	<u>60</u>	<u>72</u>	<u>30</u>	<u>59</u>
Net charge-offs .....	<u>74</u>	<u>349</u>	<u>230</u>	<u>459</u>	<u>15</u>
Provision for loan losses .....	<u>725</u>	<u>290</u>	<u>425</u>	<u>500</u>	<u>325</u>
Balance, end of year .....	\$ <u>3,643</u>	<u>2,992</u>	<u>3,051</u>	<u>2,856</u>	<u>2,815</u>
Ratio of net charge-offs during the year to average loans outstanding during the year, net of unearned discount .....	<u>.03%</u>	<u>.14%</u>	<u>.11%</u>	<u>.24%</u>	<u>.01%</u>
Allowance for loan losses as a percentage of average total loans .....	1.42%	1.33%	1.45%	1.48%	1.58%

**Noninterest Income**

During 2004, MPB earned \$3,457,000 in noninterest income, compared to \$2,707,000 earned in 2003 and \$2,022,000 earned in 2002.

Service charges on deposit accounts amounted to \$1,467,000 for 2004, an increase of \$240,000 or 19.6% over \$1,227,000 for 2003, which showed an increase of \$174,000 over 2002. The majority of this increase resulted from the increasing revenues from NSF charges.

Gains on the sale of investment securities amounted to \$475,000 in 2004 as MPB realized certain investment gains in anticipation of rising rates and diminishing gains.

MPB owns cash surrender value life insurance policies that provide funding for director retirement and salary continuation plans. The income on these policies amounted to \$211,000 during the year 2004, \$210,000 in 2003 and \$239,000 in 2002.

Trust department income for 2004 was \$248,000, a \$46,000 or 22.8% increase from the \$202,000 in 2003, which was a \$14,000 or 7.4% increase from the \$188,000 earned in 2002. Trust Department income can fluctuate from year to year, due to the number of estates being settled during the year.

MPB also earned \$162,000 in 2004, \$21,000 in 2003 and \$67,000 in 2002 in fees from the third-party provider of investments whose services the Bank has contracted. Other income amounted to \$725,000 in 2004, \$592,000 in 2003 and \$218,000 in 2002, including gains on other real estate. The increase in other noninterest income is due to the aggregate of several relatively small increases in other fee areas throughout the bank, as management continues to focus on generating noninterest income.

### Noninterest Expense

A summary of the major components of noninterest expense for the years ended December 31, 2004, 2003 and 2002 is reflected in Table 4. Noninterest expense increased to \$9,030,000 in 2004 from \$8,099,000 in 2003 and \$7,258,000 in 2002. The major component of noninterest expense is salaries and employee benefits. The number of full-time equivalent employees increased from 112 to 116 during 2004. Increases in the 2004 workforce included the addition of an experienced commercial loan officer who joined the Capital Region lending staff. A major increase in noninterest expense was the increase in expenses, primarily in licensing and maintenance, associated with the mainframe computer and imaging system implemented in 2003. The new system allows the bank to be compliant with the Check Truncation Act and also allows for labor and storage efficiencies going forward.

**TABLE 4: NONINTEREST EXPENSE**

(Dollars in thousands)

	Years ended December 31,		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Salaries and employee benefits.....	\$ 4,918	4,496	3,978
Occupancy, net .....	456	423	384
Equipment .....	631	602	514
Postage and supplies .....	308	320	278
Marketing and advertising .....	185	100	115
Other real estate, net .....	0	135	294
Pennsylvania bank shares tax .....	265	266	259
Professional services .....	113	86	160
Telephone .....	86	77	78
Loss on mortgage sales .....	66	146	79
Legal .....	100	86	17
Consultant .....	292	199	143
Debit card processing .....	214	167	207
Director fees and benefits .....	196	201	225
Computer software licensing and maintenance.....	170	91	77
Other .....	<u>1,030</u>	<u>704</u>	<u>450</u>
Total Noninterest Expense	\$ <u>9,030</u>	<u>8,099</u>	<u>7,258</u>

### Investments

MPB's investment portfolio is utilized to improve earnings through investments of funds in higher-yielding assets, while maintaining asset quality, which provide the necessary balance sheet liquidity for MPB.

MPB's entire portfolio of investment securities is considered available for sale. As such, the investments are recorded at fair value. Our investments: US Treasury, Agency and Municipal securities are given a market price relative to investments of the same type with similar maturity dates. As the interest rate environment of these securities changes, our existing securities are valued differently in comparison. This difference in value, or unrealized gain, amounted to \$693,000, net of tax, as of the end of the year.

As of December 31, 2004, SFAS No. 115 resulted in an increase in shareholders' equity of \$693,000 (unrealized gain on securities of \$1,051,000 less estimated income tax expense of \$357,000). At December 31, 2003, SFAS No. 115 resulted in an increase of shareholders' equity of \$1,415,000 (unrealized gain on securities of \$2,144,000 less estimated income tax expense of \$729,000) compared to a December 31, 2002 increase in shareholders' equity of \$1,357,000 (unrealized gain on securities of \$2,049,000, less estimated income tax expense of \$692,000).

MPB does not have any significant concentrations of investment securities.

Table 5 provides a history of the amortized cost of investment securities at December 31, for each of the past three years. The unrealized gains and losses on investment securities are outlined in Note 6 to the Consolidated Financial Statements.

**TABLE 5: AMORTIZED COST OF INVESTMENT SECURITIES**

(Dollars in thousands)	December 31,		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
U. S. Treasury and U.S. government agencies.....	\$ 11,998	10,564	9,538
Mortgage-backed U.S. government agencies.....	5,508	4,808	5,512
State and political subdivision obligations .....	22,621	34,447	39,388
Restricted equity securities.....	<u>3,435</u>	<u>2,130</u>	<u>2,372</u>
Total	\$ <u>43,561</u>	<u>51,949</u>	<u>56,810</u>

**Loans**

At December 31, 2004, net loans totaled \$275,904,000, a \$46,818,000 or 20.4% increase from December 31, 2003. During 2004, MPB experienced a net increase in commercial real estate and commercial/industrial loans of approximately \$46,626,000, the majority of which was generated in the greater Harrisburg region.

The current environment in lending remains extremely competitive with financial institutions aggressively pursuing potential borrowers. At December 31, 2004, loans, net of unearned income, represented 71.5% of earning assets as compared to 64.3% on December 31, 2003 and 64.4% on December 31, 2002.

The Bank's loan portfolio is diversified among individuals, farmers, and small and medium-sized businesses generally located within the Bank's trading area of Dauphin County, lower Northumberland County, western Schuylkill County and eastern Cumberland County. Commercial real estate, construction and land development loans are collateralized mainly by mortgages on the income-producing real estate or land involved. Commercial, industrial and agricultural loans are made to business entities and may be secured by business assets, including commercial real estate, or may be unsecured. Residential real estate loans are secured by liens on the residential property. Consumer loans include installment, lines of credit and home equity loans.

A distribution of the Bank's loan portfolio according to major loan classification is shown in Table 6.

**TABLE 6: LOAN PORTFOLIO**

(Dollars in thousands)	December 31,									
	<u>2004</u>		<u>2003</u>		<u>2002</u>		<u>2001</u>		<u>2000</u>	
	<u>Amount</u>	<u>Percent of Loans</u>	<u>Amount</u>	<u>Percent of Loans</u>	<u>Amount</u>	<u>Percent of Loans</u>	<u>Amount</u>	<u>Percent of Loans</u>	<u>Amount</u>	<u>Percent of Loans</u>
Commercial real estate, construction and land development .....	\$ 195,549	69.6%	154,296	66.5	146,325	65.6	130,983	63.8	110,947	59.3
Commercial, industrial and agricultural.....	30,940	11.0	25,567	11.0	22,398	10.0	23,107	11.3	26,274	14.1
Real estate-residential .....	43,914	15.6	43,384	18.7	41,502	18.6	38,349	18.7	35,610	19.0
Consumer .....	<u>10,680</u>	<u>3.8</u>	<u>10,380</u>	<u>3.8</u>	<u>12,978</u>	<u>5.8</u>	<u>12,732</u>	<u>6.2</u>	<u>14,110</u>	<u>7.6</u>
Total Loans	\$ <u>281,083</u>	<u>100</u>	<u>233,627</u>	<u>100</u>	<u>233,203</u>	<u>100</u>	<u>205,101</u>	<u>100</u>	<u>186,941</u>	<u>100</u>
Unearned income .....	(1,536)		(1,549)		(1,850)		(2,265)		(2,730)	
Loans net of unearned discount .....	279,547		232,078		221,353		202,836		184,211	
Allowance for loan losses .....	<u>(3,643)</u>		<u>(2,992)</u>		<u>(3,051)</u>		<u>(2,856)</u>		<u>(2,815)</u>	
Net Loans	\$ <u>275,904</u>		<u>229,086</u>		<u>218,302</u>		<u>99,980</u>		<u>181,396</u>	



**Allowance for Loan Losses**

The allowance for loan losses is maintained at a level believed adequate by Management to absorb potential loan losses in the loan portfolio. MPB has a loan review department that is charged with establishing a "watch list" of potential unsound loans, identifying unsound credit practices and suggesting corrective actions. A quarterly review and reporting process is in place for monitoring those loans that are on the "watch list." Each credit on the "watch list" is evaluated to estimate potential losses. In addition, estimates for each category of credit are provided based on Management's judgment which considers past experience, current economic conditions and other factors. For installment and real estate mortgages, specific allocations are based on past loss experience adjusted for recent portfolio growth and economic trends. The total of reserves resulting from this analysis are "specific" reserves. The amounts not specifically provided for individual classes of loans are considered "general." This amount is determined and based on judgments regarding economic conditions, trends and other factors.

The allocation of the allowance for loan losses among the major classifications is shown in Table 7 as of December 31 of each of the past five years. The allowance for loan losses at December 31, 2004 was \$3,643,000 or 1.30% of total loans less unearned discount as compared to \$2,992,000 or 1.29% at December 31, 2003, and \$3,051,000 or 1.38% at December 31, 2002.

**TABLE 7: ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES**

(Dollars in thousands)	December 31,				
	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Commercial real estate, construction and land development.....	\$ 2,368	1,938	1,898	1,584	1,318
Commercial, industrial and agricultural.....	1,093	954	922	987	1,008
Real estate-residential.....	65	20	56	73	209
Consumer .....	83	65	147	166	93
General .....	34	15	28	46	187
Total Loans	\$ <u>3,643</u>	<u>2,992</u>	<u>3,051</u>	<u>2,856</u>	<u>2,815</u>

**Nonperforming Assets**

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

Consumer loans are generally recommended for charge-off when they become 120 days delinquent. All 1-4 family residential mortgages 90 days or more past due are reviewed quarterly by Management, and collection decisions are made in light of the analysis of each individual loan. The amount of consumer and residential mortgage loans past due 90 days or more at year-end was \$397,000, \$533,000 and \$350,000 in 2004, 2003 and 2002, respectively.

A presentation of nonperforming assets as of December 31, for each of the past five years is given in Table 8. Nonperforming assets at December 31, 2004, totaled \$1,775,000 or 0.44% of total assets compared to \$2,767,000 or 0.74% of total assets in 2003, and \$2,753,000 or 0.76% of total assets in 2002. The foreclosed assets held for sale at December 31, 2004, consist of two parcels of commercial real estate and one residential property.

**TABLE 8: NONPERFORMING ASSETS**

(Dollars in thousands)	December 31,				
	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Nonaccrual loans.....	\$ 873	984	1,164	1,686	1,116
Past due 90 days or more .....	397	666	808	828	504
Restructured loans.....	<u>0</u>	<u>0</u>	<u>0</u>	<u>537</u>	<u>622</u>
Total nonperforming loans	1,270	1,650	1,972	3,051	2,242
Foreclosed assets held for sale.....	<u>505</u>	<u>1,117</u>	<u>781</u>	<u>1,693</u>	<u>70</u>
Total nonperforming assets	\$ <u>1,775</u>	<u>2,767</u>	<u>2,753</u>	<u>4,744</u>	<u>2,312</u>
Percent of loans outstanding.....	0.63%	1.18%	1.23%	2.31%	1.24%
Percent of total assets .....	0.44%	0.74%	0.76%	1.44%	0.73%

There is one loan classified for regulatory purposes that has not been included in Table 8. Management is monitoring one large commercial relationship in the amount of approximately \$3,500,000, which is not included in the table above, but has been classified by regulatory standards as substandard. Management believes this loan is adequately collateralized. There are no trends or uncertainties which Management expects will materially impact future operating results, liquidity or capital resources, or no other material credits about which Management is aware of any information which causes Management to have serious doubts as to the ability of such borrowers to comply with loan repayment terms.

#### Deposits and Other Funding Sources

MPB's primary source of funds is its deposits. Deposits at December 31, 2004, increased by \$12,806,000 or 4.4% over December 31, 2003, which also increased by \$13,635,000 or 5.0% from December 31, 2002. Average balances and average interest rates applicable to the major classifications of deposits for the years ended December 31, 2004, 2003, and 2002 are presented in Table 9.

Average short-term borrowings for 2004 were \$11,415,000 as compared to \$10,670,000 in 2003. These borrowings included customer repurchase agreements, treasury tax and loan option borrowings and federal funds purchased.

**TABLE 9: DEPOSITS BY MAJOR CLASSIFICATION**

(Dollars in thousands)	Years ended December 31,					
	<u>2004</u>		<u>2003</u>		<u>2002</u>	
	Average <u>Balance</u>	Average <u>Rate</u>	Average <u>Balance</u>	Average <u>Rate</u>	Average <u>Balance</u>	Average <u>Rate</u>
Noninterest-bearing demand deposits .....	\$ 38,884	0.00%	30,918	0.00%	28,069	0.00%
Interest-bearing demand deposits.....	34,750	0.18%	33,897	0.24%	32,480	0.52%
Money market .....	45,202	0.98%	45,072	1.42%	36,390	2.20%
Savings .....	29,027	0.27%	27,756	0.59%	26,662	1.33%
Time .....	<u>153,100</u>	<u>3.29%</u>	<u>144,194</u>	<u>3.63%</u>	<u>144,353</u>	<u>4.49%</u>
Total \$	<u>300,963</u>	<u>1.88%</u>	<u>281,837</u>	<u>2.17%</u>	<u>267,954</u>	<u>2.91%</u>

#### Capital Resources

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

In 2004, capital decreased by \$2,089,000 or 5.6%, largely due to the \$1 per share special dividend in the first quarter of 2004. In 2003, capital was increased by \$2,157,000 or 6.1%. In 2002, capital was increased by \$3,488,000 or 11.0%. Capital growth is achieved by retaining more in earnings than we pay out to our stockholders.

MPB's normal dividend payout allows for quarterly cash returns to its stockholders and provides earnings retention at a level sufficient to finance future growth. The dividend payout ratio, which represents the percentage of annual net income returned to the stockholders in the form of cash dividends, was 131% for 2004 compared to 54% for 2003 and 54% for 2002.

At December 31, 2004, 19,086 shares of MPB's common stock have been purchased back by MPB, held as treasury stock, and are available for issuance under the dividend reinvestment plan or the stock bonus plan. The treasury stock may also be used for the employee stock ownership plan.

#### **Federal Income Taxes**

Federal income tax expense for 2004 was \$1,405,000 compared to \$1,253,000 and \$1,270,000 in 2003 and 2002, respectively. The effective tax rate was 24% for 2004, 21% for 2003 and 22% for 2002.

#### **Liquidity**

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

The major sources of cash in 2004 came from operations, a net increase of long-term borrowings of \$14,273,000, an increase in deposits of \$12,806,000, a net decrease in interest-bearing balances (certificates of deposit of other banks) of \$9,511,000, and a net decrease in investment securities of \$9,480,000.

The major use of cash during the year was the funding of a net increase in loans of more than \$46 million. Another major use of cash during the year was the payment of \$5,739,000 in cash dividends. This amount included the \$1 per share special dividend, which was paid in the first quarter of 2004.

The major sources of cash in 2003 came from operations and a net increase in deposits of \$13,635,000. Deposits grew at a slower pace in 2003 due to improving equity markets. In addition, net long-term debt was increased by approximately \$3,301,000 as the Bank locked into several new borrowings at the favorable current rate levels.

In 2003, the major use of cash was for net loan growth of \$13,530,000. Loan growth in 2003 was slower than the prior year, due to a slow economy and heightened competition for commercial loans. Excess cash generated was used to pay down short-term borrowings.

#### **Market Risk - Asset-Liability Management and Interest Rate Sensitivity**

Interest rate sensitivity is a function of the repricing characteristics of MPB's portfolio of assets and liabilities. Each asset and liability reprices either at maturity or during the life of the instrument. Interest rate sensitivity is measured as the difference between the volume of assets and liabilities that are subject to repricing in a future period of time. These differences are known as interest sensitivity gaps.

MPB manages the interest rate sensitivity of its assets and liabilities. The principal purpose of asset-liability management is to maximize net interest income while avoiding significant fluctuations in the net interest margin and maintaining adequate liquidity. Net interest income is increased by increasing the net interest margin and by increasing earning assets.

MPB utilizes asset-liability management models to measure the impact of interest rate movements on its interest rate sensitivity position. The traditional maturity gap analysis is also reviewed regularly by MPB's management. MPB does not attempt to achieve an exact match between interest sensitive assets and liabilities because it believes that a controlled amount of interest rate risk is desirable.

The maturity distribution and weighted average yields of investments is presented in Table 10. The maturity distribution and repricing characteristics of MPB's loan portfolio is shown in Table 11. Table 12 provides expected maturity information about MPB's financial instruments that are sensitive to changes in interest rates. Except for the effects of prepayments on mortgage related assets, the table presents principal cash flows and related average interest rates on interest earning assets by contractual maturity. Residential loans are assumed to have annual payment rates between 12% and 18% of the portfolio. Loan and mortgage backed securities balances are not adjusted for unearned discounts, premiums, and deferred loan fees.

MPB assumes that 75% of savings and NOW accounts are core deposits and are, therefore, expected to reprice after 5 years. Transaction accounts, excluding money market accounts, are assumed to reprice after five years. Money market accounts are assumed to be variable accounts and are reported as maturing within the first twelve months. No roll-off is applied to certificates of deposit. Fixed maturity deposits reprice at maturity. The maturity distribution of time deposits of \$100,000 or more is shown in Table 13.

**TABLE 10: INVESTMENT MATURITY AND YIELD**

(Dollars in thousands)

		December 31, 2004				<u>Total</u>
		<u>One Year and Less</u>	<u>After One Year thru Five Years</u>	<u>After Five Years thru Ten Years</u>	<u>After Ten Years</u>	
U.S. Treasury and U.S. government agencies .....	\$	1,000	5,500	3,500	1,998	11,998
State and political subdivision obligations .....		240	1,331	9,742	11,255	22,568
Mortgage-backed U.S. government agencies .....		0	263	86	5,159	5,508
Equity securities.....		0	0	0	3,435	3,435
<b>Total</b>	<b>\$</b>	<b>1,240</b>	<b>7,094</b>	<b>13,328</b>	<b>21,847</b>	<b>43,509</b>

		<u>One Year and Less</u>	<u>After One Year thru Five Years</u>	<u>After Five Years thru Ten Years</u>	<u>After Ten Years</u>	<u>Total</u>
<u>Weighted Average Yields</u>						
U.S. Treasury and U.S. government agencies .....		6.20%	3.35	4.06	4.65	4.01
State and political subdivision obligations.....		5.59	6.27	6.85	7.08	6.91
Mortgage-backed U.S. government agencies .....		0	5.47	6.51	5.02	5.06
Equity securities .....		0	0	0	1.50	1.50
<b>.....Total</b>		<b>6.08%</b>	<b>3.98</b>	<b>6.12</b>	<b>5.49</b>	<b>5.45</b>

**TABLE 11: LOAN MATURITY AND INTEREST SENSITIVITY**

(Dollars in thousands)

		December 31, 2004			
		<u>One Year and Less</u>	<u>After One Year thru Five Years</u>	<u>After Five Years</u>	<u>Total</u>
Commercial, real estate, construction and land development .....	\$	67,366	94,294	33,889	195,549
Commercial, industrial and agricultural .....		17,523	8,007	5,410	30,940
Real estate-residential mortgages .....		14,834	18,619	10,461	43,914
Consumer .....		1,570	7,718	1,392	10,680
<b>Total Loans</b>	<b>\$</b>	<b>101,293</b>	<b>128,638</b>	<b>51,152</b>	<b>281,083</b>

<u>Rate Sensitivity</u>					
Predetermined rate .....	\$	9,597	28,637	46,192	84,426
Floating or adjustable rate.....		91,696	100,001	4,960	196,657
<b>Total</b>	<b>\$</b>	<b>101,293</b>	<b>128,638</b>	<b>51,152</b>	<b>281,083</b>

**TABLE 12: INTEREST RATE SENSITIVITY GAP**

(Dollars in thousands)  
(As of December 31, 2004)

		Expected Maturity					Total	Fair Value	
		Year Ended December 31,							
		2005	2006	2007	2008	2009	Thereafter		
<b>Assets:</b>									
Interest bearing balances .....	\$	43,967	3,663	99	5,645	6,934	99	60,407	60,407
Average interest rate.....		2.73	3.32	5.05	3.74	3.91	4.40	3.00	
Debt securities .....		1,240	355	551	4,263	1,925	31,741	40,075	41,129
Average interest rate.....		6.08	7.94	6.21	3.40	4.51	6.19	5.79	
Adjustable rate loans .....		91,696	20,034	22,002	30,896	27,069	4,960	196,657	196,657
Average interest rate.....		5.91	6.65	6.73	6.07	6.25	5.55	6.14	
Fixed rate loans .....		9,371	4,431	10,200	6,235	6,661	45,993	82,891	86,484
Average interest rate.....		6.68	7.10	6.61	6.48	6.49	6.24	6.42	
<b>Total</b>	<b>\$</b>	<b>146,274</b>	<b>28,483</b>	<b>32,852</b>	<b>47,039</b>	<b>42,589</b>	<b>82,793</b>	<b>380,030</b>	<b>384,677</b>
<b>Interest liabilities:</b>									
Variable rate savings and transaction accounts .....	\$	59,109	0	0	0	0	85,569	144,678	144,678
Average interest rate.....		0.77					0.12	0.38	
Certificates of deposit and IRAs .....		57,216	33,376	37,993	12,720	13,007	2,154	156,466	157,839
Average interest rate.....		2.75	3.08	3.73	3.46	3.99	3.95	3.24	
Short term borrowings .....		13,801	0	0	0	0	0	13,801	13,801
Average interest rate.....		2.25						2.25	
Long term fixed rate borrowings.....		0	10,000	5,000	5,000	12,000	17,957	49,957	53,081
Average interest rate.....		-	4.19	3.71	3.08	5.63	5.68	4.91	
<b>Total</b>	<b>\$</b>	<b>130,126</b>	<b>43,376</b>	<b>42,993</b>	<b>17,720</b>	<b>25,007</b>	<b>105,680</b>	<b>364,902</b>	<b>369,399</b>
<b>Rate sensitive gap:</b>									
Periodic gap .....	\$	16,148	(14,893)	(10,141)	29,319	17,582	(22,887)		
Cumulative gap .....	\$	16,148	1,255	(8,886)	20,433	38,015	15,128		
<b>Cumulative gap as a percentage</b>									
of total assets .....		+4.0%	+0.3	-2.2	+5.1	+9.4	+3.8		

(Dollars in thousands)  
(As of December 31, 2003)

		Expected Maturity					Total	Fair Value	
		Year Ended December 31,							
		2004	2005	2006	2007	2008	Thereafter		
<b>Assets:</b>									
Interest bearing balances .....	\$	51,855	12,180	297	99	5,487	0	69,918	69,918
Average interest rate.....		2.40	2.89	6.68	5.05	3.73	-	2.61	
Debt securities .....		814	4,064	1,927	662	4,994	37,322	49,783	54,093
Average interest rate.....		6.37	6.13	5.51	5.41	3.36	6.62	6.19	
Adjustable rate loans .....		92,340	16,502	17,954	15,145	28,510	1,949	172,400	172,400
Average interest rate.....		5.31	6.91	6.79	6.60	5.99	5.01	5.84	
Fixed rate loans .....		5,066	5,823	5,727	6,912	6,867	29,283	59,678	67,412
Average interest rate.....		7.28	7.61	7.29	7.05	6.45	7.05	7.08	
<b>Total</b>	<b>\$</b>	<b>150,075</b>	<b>38,569</b>	<b>25,905</b>	<b>22,818</b>	<b>45,858</b>	<b>68,554</b>	<b>351,779</b>	<b>363,823</b>

**TABLE 12: INTEREST RATE SENSITIVITY GAP (cont'd)**

(Dollars in thousands) (As of December 31, 2003)	Expected Maturity Year Ended December 31,						<u>Total Fair Value</u>	
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>Thereafter</u>		
<b>Interest liabilities:</b>								
Variable rate savings and transaction accounts.....	\$ 61,611	0	0	0	0	79,279	140,890	140,890
Average interest rate .....	0.91	-	-	-	-	0.18	0.50	
Certificates of deposit and IRAs .....	59,605	29,705	19,769	21,612	12,364	2,463	145,518	151,316
Average interest rate .....	2.70	4.08	3.48	4.29	3.55	3.91	3.42	
Short term borrowings.....	9,688	0	0	0	0	0	9,688	9,688
Average interest rate .....	1.06	-	-	-	-	-	1.06	
Long term fixed rate borrowings .....	5,088	0	5,000	0	0	25,596	35,684	38,321
Average interest rate .....	5.24	-	6.21	-	-	5.84	5.81	
<b>Total</b>	<b>\$ 135,992</b>	<b>29,705</b>	<b>24,769</b>	<b>21,612</b>	<b>12,364</b>	<b>107,338</b>	<b>331,780</b>	<b>340,215</b>
<b>Rate sensitive gap:</b>								
Periodic gap.....	\$ 14,083	8,864	1,136	1,206	33,494	(38,784)		
Cumulative gap .....	\$ 14,083	22,947	24,083	25,289	58,783	19,999		
<b>Cumulative gap as a percentage</b>								
of total assets .....	+3.7%	+6.1	+6.4	+6.8	+15.7	+5.4		

During 2004, Management analyzed interest rate risk using the Profit Star Asset-Liability Management Model. Using the computerized model, Management reviews interest rate risk on a monthly basis. This analysis includes an earnings scenario whereby interest rates are increased by 200 basis points and another whereby they are decreased by 200 basis points. These scenarios indicate that there would not be a significant variance in net interest income at the one-year time frame due to interest rate changes; however, actual results could vary significantly from the calculations prepared by Management. At December 31, 2004, all interest rate risk levels according to our model were within the tolerance guidelines set by Management. The model noted above utilized by Management to create the reports used for Table 12 makes various assumptions and estimates. Actual results could differ significantly from these estimates which would result in significant differences in cash flows. In addition, the table does not take into consideration changes which Management would make to realign its portfolio in the event of a changing rate environment.

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

(Dollars in thousands)	December 31,		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Three months or less.....	\$ 7,431	4,821	5,757
Over three months to twelve months .....	6,771	7,104	6,179
Over twelve months.....	<u>13,681</u>	<u>12,673</u>	<u>12,895</u>
<b>Total</b>	<b>\$ 27,883</b>	<b>24,598</b>	<b>24,831</b>

**Effects of Inflation**

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

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

**Off-Balance Sheet Items**

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

As of December 31, 2004, commitments to extend credit amounted to \$61,028,000 as compared to \$48,786,000 as of December 31, 2003.

MPB also issues financial standby letters of credit to its customers. The risk associated with financial standby letters of credit is essentially the same as the credit risk involved in loan extensions to customers. Financial standby letters of credit increased to \$11,904,000 at December 31, 2004, from \$5,804,000 at December 31, 2003.

**Comprehensive Income**

Comprehensive Income is a measure of all changes in equity of a corporation, excluding transactions with owners in their capacity as owners (such as proceeds from issuances of stock and dividends). The difference between Net Income and Comprehensive Income is termed "Other Comprehensive Income." For MPB, Other Comprehensive Income consists of unrealized gains and losses on available-for-sale securities, net of deferred income tax. Comprehensive Income should not be construed to be a measure of net income. The effect of Other Comprehensive Income would only be reflected in the income statement if the entire portfolio of available-for-sale securities were sold on the statement date. The amount of unrealized gains or losses reflected in Comprehensive Income may vary widely at statement dates depending on the markets as a whole and how the portfolio of available-for-sale securities is affected by interest rate movements. Other Comprehensive Income for the years ended December 31, 2004, 2003 and 2002 was (\$722,000), \$58,000 and \$1,413,000, respectively.

**Summary of Selected Financial Data**

(Dollars in thousands, except per share data)

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>INCOME:</b>					
Total Interest Income .....	\$ 20,077	19,984	21,352	22,864	22,053
Total Interest Expense .....	8,005	8,434	9,926	11,735	11,455
Net Interest Income .....	12,072	11,550	11,426	11,129	10,598
Provision for Possible Loan Losses .....	725	290	425	500	325
Noninterest Income .....	3,457	2,707	2,022	1,845	1,556
Noninterest Expense .....	9,030	8,099	7,258	7,026	6,656
Income Before Income Taxes .....	5,774	5,868	5,765	5,448	5,203
Provision for Income Taxes .....	1,405	1,253	1,270	1,218	1,255
Net Income .....	4,369	4,615	4,495	4,230	3,948
<b>COMMON STOCK DATA PER SHARE:</b>					
Earnings Per Share .....	\$ 1.37	1.45	1.41	1.33	1.24
Cash Dividends Declared .....	1.80	.80	.80	.80	.80
Stockholders' Equity .....	11.06	11.72	11.04	9.94	9.29
<b>AVERAGE SHARES OUTSTANDING .....</b>	<b>3,188,867</b>	<b>3,188,504</b>	<b>3,188,333</b>	<b>3,190,802</b>	<b>3,187,807</b>
<b>AT YEAR-END:</b>					
Investments .....	\$ 44,613	54,093	58,859	55,348	73,885
Loans, Net of Unearned Discount .....	279,547	232,078	221,353	202,836	184,211
Allowance for Loan Losses .....	3,643	2,992	3,051	2,856	2,815
Total Assets .....	403,256	373,466	363,284	330,635	315,584
Total Deposits .....	301,144	288,338	274,703	254,105	231,408
Short-term Borrowings .....	13,801	9,688	18,156	9,610	22,738
Long-term Debt .....	49,957	35,684	32,383	32,568	29,241
Stockholders' Equity .....	\$ 35,272	37,361	35,204	31,716	29,626
<b>RATIOS:</b>					
Return on Average Assets .....	1.12	1.25	1.32	1.31	1.34
Return on Average Stockholders' Equity .....	12.73	12.69	13.60	13.68	14.64
Cash Dividend Payout Ratio .....	131.38	54.48	54.05	57.55	61.54
Allowance for Loan Losses to Loans .....	1.30	1.29	1.38	1.41	1.53
Average Stockholders' Equity to Average Assets .....	8.75	9.97	9.67	9.67	9.15

**DIRECTORS**

**Mid Penn Bancorp, Inc.**  
**Mid Penn Bank**

**Jere M. Coxon**  
Executive Vice President  
Penn Wood Products, Inc.

**Alan W. Dakey**  
President and CEO  
Mid Penn Bank

**A. James Durica**  
Consultant

**Gregory M. Kerwin**  
Senior Partner  
Kerwin & Kerwin, Attorneys

**Theodore W. Mowery**  
Partner  
Gunn-Mowery Insurance  
Group, Inc.

**William G. Nelson**  
President  
Hess Trucking Co., Inc.

**Donald E. Sauve**  
Consultant  
Don's Food Market, Inc.

**Edwin D. Schlegel**  
Retired Superintendent  
Millersburg Area School District

**Eugene F. Shaffer**  
Chairman  
Mid Penn Bank

**Guy J. Snyder, Jr.**  
President  
Snyder Fuels, Inc.

**DIRECTORS EMERITI**

**Guy F. Bucher**  
**Earl R. Etzweiler**  
**Harvey J. Hummel**  
**Charles F. Lebo**  
**Warren A. Miller**  
**Charles R. Phillips**  
**Anna C. Woodside**

**EXECUTIVE OFFICERS**

**Mid Penn Bancorp, Inc.**

**Eugene F. Shaffer**  
Chairman

**William G. Nelson**  
Vice Chairman

**Alan W. Dakey**  
President and CEO

**Kevin W. Laudenslager**  
Treasurer

**Cindy L. Wetzel**  
Secretary

**SENIOR MANAGEMENT**

**Mid Penn Bank**

**Eugene F. Shaffer**  
Chairman  
*48 Years Banking Experience*

**Alan W. Dakey**  
President and CEO  
*31 Years Banking Experience*

**Kevin W. Laudenslager**  
Executive Vice President and Chief  
Financial Officer  
*20 Years Banking Experience*

**Eric S. Williams**  
Executive Vice President and  
Senior Commercial Loan Officer  
*26 Years Banking Experience*

**Randall L. Klinger**  
Senior Vice President  
and Senior Credit Officer  
*31 Years Banking Experience*

**Allen J. Trawitz**  
Executive Vice President  
*36 Years Banking Experience*

**Donald J. Bonafede**  
Vice President and  
Director of Equipment Leasing  
*22 Years Banking Experience*

**Kathy I. Bordner**  
Vice President and Marketing Director  
*20 Years Banking Experience*

**Nelson E. Carr**  
Vice President and Business  
Development Officer  
*44 Years Banking Experience*

**J. Martin Dell**  
Vice President and Commercial Loan Officer  
*30 Years Banking Experience*

**William R. Feist, IV**  
Vice President and Commercial Loan Officer  
*10 Years Banking Experience*

**Roberta A. Hoffman, PHR**  
Vice President, Human Resources  
Officer and Asst. Secretary  
*29 Years Banking Experience*

**Michael T. Lehmer**  
Vice President and Senior Trust Officer  
*14 Years Banking Experience*

**Craig E. Morrow**  
Vice President and Retail Division Manager  
*18 Years Banking Experience*

**Eric D. Mummau**  
Vice President and Commercial Loan Officer  
*25 Years Banking Experience*

**Brad N. Shaak**  
Vice President, Consumer and Mortgage  
Lending Manager  
*18 Years Banking Experience*

**Steven S. Shuey**  
Vice President and Loan Review Officer  
*31 Years Banking Experience*

**Dennis E. Spotts**  
Vice President and Operations Officer  
*32 Years Banking Experience*

**Cindy L. Wetzel**  
Vice President and Corporate Secretary  
*26 Years Banking Experience*

**CAPITAL AREA ADVISORY BOARD**  
**Mid Penn Bank**

**Robert C. Grubic**  
**Norman K.A. Hoffer**  
**Norman L. Houser**  
**Theodore W. Mowery**  
**Robert M. Newbury**  
**David J. Rimmel**



# mid penn bancorp **office locations**

## **Capital Region Locations:**

**HARRISBURG** 4098 Derry Street • Harrisburg, PA 17111 • (717) 558-2144

**HARRISBURG** 2615 North Front Street • Harrisburg, PA 17110 • (717) 233-7380

**CARLISLE PIKE** 4622 Carlisle Pike • Mechanicsburg, PA 17050 • (717) 761-2480

OPENING SOON

**HARRISBURG** 5500 Allentown Boulevard • Harrisburg, PA 17112

**HARRISBURG** 17-21 North Second Street • Harrisburg, PA 17101

## **Northern Region Locations:**

**MILLERSBURG** 349 Union Street • Millersburg, PA 17061 • (717) 692-2133

**ELIZABETHVILLE** 2 East Main Street • Elizabethville, PA 17023 • (717) 362-8147

**DALMATIA** PO Box 205, School Road • Dalmatia, PA 17017 • (570) 758-2711

**HALIFAX** Halifax Shopping Center • 3763 Peters Mountain Road • Halifax, PA 17032 • (717) 896-8258

**DAUPHIN** 1001 Peters Mountain Road • Dauphin, PA 17018 • (717) 921-8899

**MINERS-LYKENS** 550 Main Street • Lykens, PA 17048 • (717) 453-7185

**TOWER CITY** 545 Grand Avenue • Tower City, PA 17980 • (717) 647-2157

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## Mission **Statement:**

Mid Penn Bank and our employees promise to work hard to meet the expectations of our brand promise - Making things happen for you. Through hard work and dedication, we continue to make things happen for our customers and our shareholders today, as we have since 1868.

To the best of our ability, each employee will identify and meet the financial needs of our customers and support the financial expectations of our shareholders. Highly satisfied customers are the key to superior results, which bring rewards for our shareholders and our employees, as well as satisfaction in a job well done.



[www.midpennbank.com](http://www.midpennbank.com)