

BRYN MAWR BANK CORP  
Form 10-Q  
August 06, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

**Quarterly Report Under Section 13 or 15 (d)**  
**of the Securities and Exchange Act of 1934.**

**For Quarter ended June 30, 2008**

**Commission File Number 0-15261**

**Bryn Mawr Bank Corporation**

(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of

**23-2434506**  
(I.R.S. Employer

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incorporation or organization)

identification No.)

801 Lancaster Avenue, Bryn Mawr, Pennsylvania  
(Address of principal executive offices)

19010  
(Zip Code)

Registrant's telephone number, including area code (610) 525-1700

Not Applicable

Former name, former address and fiscal year, if changed since last report.

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of accelerated filer, large accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes  No

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of the latest practicable date.

| Class                       | Outstanding at August 2, 2008 |
|-----------------------------|-------------------------------|
| Common Stock, par value \$1 | 8,575,677                     |

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**BRYN MAWR BANK CORPORATION AND SUBSIDIARIES**

**FORM 10-Q**

**QUARTER ENDED June 30, 2008**

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Income - Unaudited**

| (dollars in thousands, except per share data)           | Three Months Ended<br>June 30 |           | Six Months Ended<br>June 30 |           |
|---|-------------------------------|-----------|-----------------------------|-----------|
|   | 2008                          | 2007      | 2008                        | 2007      |
| <b>Net interest income:</b>                             |                               |           |                             |           |
| <b>Interest income:</b>                                 |                               |           |                             |           |
| Loans   | \$ 11,571                     | \$ 12,049 | \$ 23,532                   | \$ 23,650 |
| Leases  | 1,444                         | 624       | 2,760                       | 933       |
| Federal funds sold                                      | 18                            | 14        | 78                          | 48        |
| Interest bearing deposits with banks                    | 13                            | 7         | 55                          | 14        |
| Investment securities                                   | 1,186                         | 556       | 1,869                       | 1,126     |
| Total interest income                                   | 14,232                        | 13,250    | 28,294                      | 25,771    |
| <b>Interest expense:</b>                                |                               |           |                             |           |
| Savings, NOW, and market rate accounts                  | 794                           | 977       | 1,851                       | 1,974     |
| Time deposits   | 1,353                         | 1,982     | 3,468                       | 4,166     |
| Wholesale deposits                                      | 1,591                         | 1,132     | 3,236                       | 1,554     |
| Borrowed funds  | 1,191                         | 645       | 1,828                       | 1,187     |
| Total interest expense                                  | 4,929                         | 4,736     | 10,383                      | 8,881     |
| Net interest income                                     | 9,303                         | 8,514     | 17,911                      | 16,890    |
| <b>Loan and lease loss provision</b>                    | 781                           | 240       | 1,635                       | 490       |
| Net interest income after loan and lease loss provision | 8,522                         | 8,274     | 16,276                      | 16,400    |
| <b>Non-interest income:</b>                             |                               |           |                             |           |
| Fees for wealth management services                     | 3,291                         | 3,423     | 6,603                       | 6,710     |
| Service charges on deposit accounts                     | 429                           | 356       | 821                         | 716       |
| Loan servicing and other fees                           | 305                           | 277       | 615                         | 557       |
| Net gain on sale of loans                               | 363                           | 259       | 695                         | 539       |
| Net gain on sale of OREO                                |                               | 110       |                             | 110       |
| Net gain on sale of real estate                         |                               |           |                             | 1,333     |
| BOLI income   | 117                           | 84        | 260                         | 84        |
| Net gain on sale of investments                         |                               |           | 222                         |           |
| Interest rate floor income                              |                               |           | 268                         |           |
| Other operating income                                  | 727                           | 555       | 1,378                       | 1,161     |
| Total non-interest income                               | 5,232                         | 5,064     | 10,862                      | 11,210    |
| <b>Non-interest expenses:</b>                           |                               |           |                             |           |
| Salaries and wages                                      | 4,532                         | 3,981     | 9,011                       | 8,029     |
| Employee benefits                                       | 947                           | 1,057     | 2,279                       | 2,278     |
| Occupancy and bank premises                             | 715                           | 712       | 1,465                       | 1,398     |
| Furniture, fixtures, and equipment                      | 565                           | 513       | 1,114                       | 1,020     |
| Advertising   | 222                           | 355       | 494                         | 671       |

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|   |              |              |               |               |
|---|--------------|--------------|---------------|---------------|
| Amortization of mortgage servicing rights | 89           | 77           | 214           | 169           |
| Professional fees                         | 364          | 470          | 683           | 871           |
| Other operating expenses                  | 1,569        | 1,588        | 2,822         | 2,752         |
| <b>Total non-interest expenses</b>        | <b>9,003</b> | <b>8,753</b> | <b>18,082</b> | <b>17,188</b> |
| Income before income taxes                | 4,751        | 4,585        | 9,056         | 10,422        |
| <b>Income taxes</b>                       | <b>1,586</b> | <b>1,494</b> | <b>2,993</b>  | <b>3,355</b>  |
| Net income                                | \$ 3,165     | \$ 3,091     | \$ 6,063      | \$ 7,067      |
| Basic earnings per share                  | \$ 0.37      | \$ 0.36      | \$ 0.71       | \$ 0.83       |
| Diluted earnings per share                | \$ 0.37      | \$ 0.36      | \$ 0.71       | \$ 0.81       |
| Dividends declared per share              | \$ 0.13      | \$ 0.12      | \$ 0.26       | \$ 0.24       |
| Weighted-average basic shares outstanding | 8,571,143    | 8,542,066    | 8,552,805     | 8,558,527     |
| Dilutive potential common shares          | 31,836       | 112,040      | 30,125        | 116,727       |
| Weighted-average dilutive shares          | 8,602,979    | 8,654,106    | 8,582,930     | 8,675,254     |

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

**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Balance Sheets - Unaudited**

| (dollars in thousands, except per share data)   | June 30,<br>2008 | December 31,<br>2007 |
|---|------------------|----------------------|
| <b>Assets</b>   |                  |                      |
| Cash and due from banks   | \$ 25,901        | \$ 76,965            |
| Interest bearing deposits with banks  | 621              | 1,209                |
| Federal funds sold  |                  | 17,000               |
| Total cash and cash equivalents   | 26,522           | 95,174               |
| Investment securities available for sale, at fair value (amortized cost of \$113,276 and \$48,236 as of June 30, 2008 and December 31, 2007, respectively)  | 111,870          | 48,402               |
| Loans held for sale   | 2,304            | 5,125                |
| Portfolio loans and leases  | 853,355          | 802,925              |
| Less: Allowance for loan and lease losses   | (8,672)          | (8,124)              |
| Net portfolio loans and leases  | 844,683          | 794,801              |
| Premises and equipment, net   | 18,244           | 16,952               |
| Accrued interest receivable   | 4,065            | 4,316                |
| Deferred income taxes   | 3,569            | 2,891                |
| Mortgage servicing rights   | 2,890            | 2,820                |
| Bank Owned Life Insurance ( BOLI )  | 15,684           | 15,424               |
| Other assets  | 19,421           | 16,191               |
| Total assets  | \$ 1,049,252     | \$ 1,002,096         |
| <b>Liabilities</b>  |                  |                      |
| Deposits:   |                  |                      |
| Noninterest-bearing demand  | \$ 141,114       | \$ 228,269           |
| Savings, NOW and market rate accounts   | 301,980          | 287,977              |
| Wholesale deposits  | 144,049          | 129,820              |
| Time deposits   | 166,679          | 203,462              |
| Total deposits  | 753,822          | 849,528              |
| Borrowed funds  | 182,293          | 45,000               |
| Accrued interest payable  | 3,142            | 6,294                |
| Unsettled securities payable  | 4,954            |                      |
| Other liabilities   | 11,006           | 10,923               |
| Total liabilities   | 955,217          | 911,745              |
| <b>Shareholders equity</b>  |                  |                      |
| Common stock, par value \$1; authorized 100,000,000 shares as of June 30, 2008 and December 31, 2007 respectively; issued 11,492,782 and 11,434,332 shares as of June 30, 2008 and December 31, 2007 respectively and outstanding of 8,572,777 and 8,526,084 shares as of June 30, 2008 and December 31, 2007, respectively | 11,493           | 11,434               |
| Paid-in capital in excess of par value  | 12,660           | 11,698               |
| Accumulated other comprehensive income, net of taxes  | (5,195)          | (4,304)              |
| Retained earnings   | 104,986          | 101,146              |

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|   |                 |                 |
|---|-----------------|-----------------|
|   | 123,944         | 119,974         |
| Less: Common stock in treasury at cost 2,920,005, and 2,908,248 shares as of June 30, 2008 and December 31, 2007 respectively | (29,909)        | (29,623)        |
| <b>Total shareholders equity</b>  | <b>94,035</b>   | <b>90,351</b>   |
| Total liabilities and shareholders equity   | \$ 1,049,252    | \$ 1,002,096    |
| <b>Book value per share</b>   | <b>\$ 10.97</b> | <b>\$ 10.60</b> |

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



**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows - Unaudited**

| (dollars in thousands)   | Six Months Ended<br>June 30 |               |
|--|-----------------------------|---------------|
|  | 2008                        | 2007          |
| <b>Operating activities:</b>   |                             |               |
| Net income   | \$ 6,063                    | \$ 7,067      |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: |                             |               |
| Provision for loan and lease losses  | 1,635                       | 490           |
| Provision for depreciation and amortization  | 852                         | 775           |
| Loans originated for resale  | (44,627)                    | (45,073)      |
| Proceeds from loans sold   | 48,143                      | 42,803        |
| Net gain on sale of loans  | (695)                       | (539)         |
| Net gain on sale of real estate  |                             | (1,333)       |
| Provision for deferred income taxes (benefit)  | (199)                       | (388)         |
| Change in income tax payable/receivable  | 306                         | 528           |
| Change in accrued interest receivable  | 251                         | 78            |
| Change in accrued interest payable   | (3,152)                     | (251)         |
| Change in mortgage servicing rights, net   | (70)                        | 71            |
| Other, net   | (3,523)                     | (2,277)       |
| <br>Net cash provided by operating activities  | <br>4,984                   | <br>1,951     |
| <b>Investing activities:</b>   |                             |               |
| Purchases of investment securities   | (95,872)                    | (421)         |
| Proceeds from sale of investment securities available for sale                           | 21,004                      |               |
| Proceeds from maturity of investment securities and mortgage-backed securities pay downs | 5,782                       | 3,655         |
| Proceeds from calls of investment securities   | 9,000                       |               |
| Proceeds from sale of real estate  |                             | 1,850         |
| Purchase of BOLI   |                             | (15,000)      |
| Net portfolio loan and lease originations  | (51,517)                    | (58,377)      |
| Net change in premises and equipment   | (2,082)                     | (1,292)       |
| Sale of other real estate owned ( OREO )   |                             | 110           |
| <br>Net cash used by investing activities  | <br>(113,685)               | <br>(69,475)  |
| <b>Financing activities:</b>   |                             |               |
| Change in demand, NOW, savings and market rate deposit accounts                          | (73,152)                    | (73,219)      |
| Change in time deposits  | (36,783)                    | 15,599        |
| Change in wholesale deposits   | 14,229                      | 71,774        |
| Dividends paid   | (2,223)                     | (2,054)       |
| Increase in borrowed funds   | 137,293                     | 20,100        |
| Purchase of treasury stock   | (286)                       | (2,088)       |
| Tax benefit from exercise of stock options   | 116                         | 168           |
| Proceeds from exercise of stock options  | 855                         | 792           |
| <br>Net cash provided by financing activities  | <br>40,049                  | <br>31,072    |
| <br>Change in cash and cash equivalents  | <br>(68,652)                | <br>(36,452)  |
| Cash and cash equivalents at beginning of period   | 95,174                      | 62,005        |
| <br>Cash and cash equivalents at end of period   | <br>\$ 26,522               | <br>\$ 25,553 |

**Supplemental cash flow information:**

Cash paid during the year for:

|                   |           |          |
|-------------------|-----------|----------|
| Income taxes paid | \$ 3,041  | \$ 3,184 |
| Interest paid     | \$ 13,535 | \$ 9,132 |

**Supplemental non-cash investing and financing activities:**

|  |          |      |
|--|----------|------|
| Unsettled AFS securities                                       | \$ 4,954 | \$   |
| Change in other comprehensive income                           | 1,370    | 172  |
| Change in deferred taxes due to change in comprehensive income | (479)    | (60) |

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

**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Comprehensive Income****Unaudited**

| (dollars in thousands)  | Three Months Ended<br>June 30 |                 |
|---|-------------------------------|-----------------|
|   | 2008                          | 2007            |
| Net income  | \$ 3,165                      | \$ 3,091        |
| Other comprehensive income:   |                               |                 |
| Unrealized investment losses net of tax benefit of \$683 and \$110, respectively        | (1,268)                       | (205)           |
| Change in unfunded pension liability, net of tax expense of \$71 and \$26, respectively | 131                           | 49              |
| <b>Total comprehensive income</b>   | <b>\$ 2,028</b>               | <b>\$ 2,935</b> |

| (dollars in thousands)  | Six Months Ended<br>June 30 |                 |
|---|-----------------------------|-----------------|
|   | 2008                        | 2007            |
| Net income  | \$ 6,063                    | \$ 7,067        |
| Other comprehensive income:   |                             |                 |
| Unrealized investment losses net of tax expense benefit of \$550 and \$67, respectively | (1,023)                     | (122)           |
| Change in unfunded pension liability, net of tax expense of \$72 and \$6, respectively  | 132                         | 11              |
| <b>Total comprehensive income</b>   | <b>\$ 5,172</b>             | <b>\$ 6,956</b> |

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

**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements****June 30, 2008 and 2007****(Unaudited)****1. Basis of Presentation:**

The unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. In the opinion of Bryn Mawr Bank Corporation's (the Corporation) Management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the consolidated financial position and the results of operations for the interim period presented have been included. **These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto in the Corporation's 2007 Annual Report on Form 10-K.** The Corporation's consolidated financial condition and results of operations consist almost entirely of The Bryn Mawr Trust Company's (the Bank) financial condition and results of operations.

The results of operations for the three month and six month periods ended June 30, 2008 are not necessarily indicative of the results to be expected for the full year.

Statements of the Financial Accounting Standards Board are noted in these statements by the abbreviation FAS. Staff Accounting Bulletins of the Securities and Exchange Commission (SEC) are noted by the abbreviation SAB.

**2. Earnings Per Common Share:**

The Corporation follows the provisions of FAS No. 128, Earnings Per Share (FAS 128). Basic earnings per common share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average common shares outstanding during the period. Diluted earnings per common share takes into account the potential dilution, computed pursuant to the treasury stock method, that could occur if stock options were exercised and converted into common stock. The effects of stock options are excluded from the computation of diluted earnings per share in periods in which the effect would be antidilutive. All weighted average shares, actual shares and per share information in the financial statements have been adjusted retroactively for the effect of stock dividends and splits.

| (dollars in thousands, except per share data)  | Three Months Ended<br>June 30 |           | Six Months Ended<br>June 30 |           |
|--|-------------------------------|-----------|-----------------------------|-----------|
|  | 2008                          | 2007      | 2008                        | 2007      |
| <b>Numerator:</b>  |                               |           |                             |           |
| Net income available to common shareholders  | \$ 3,165                      | \$ 3,091  | \$ 6,063                    | \$ 7,067  |
| <b>Denominator for basic earnings per share</b> - weighted average shares            |                               |           |                             |           |
| outstanding  | 8,571,143                     | 8,542,066 | 8,552,805                   | 8,558,527 |
| Effect of dilutive potential common shares   | 31,836                        | 112,040   | 30,125                      | 116,727   |
| <b>Denominator for diluted earnings per share</b> - adjusted weighted average        |                               |           |                             |           |
| shares outstanding   | 8,602,979                     | 8,654,106 | 8,582,930                   | 8,675,254 |
| Basic earnings per share   | \$ 0.37                       | \$ 0.36   | \$ 0.71                     | \$ 0.83   |
| Diluted earnings per share   | \$ 0.37                       | \$ 0.36   | \$ 0.71                     | \$ 0.81   |
| Antidilutive shares excluded from computation of average dilutive earnings per share | 274,037                       | 10,000    | 276,556                     | 9,227     |

**3. Allowance for Loan and Lease Losses**

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The allowance for loan and lease losses is established through a provision for loan and lease losses charged as an expense. Loans are charged against the allowance for loan and lease losses when Management believes that such amounts are uncollectible. The allowance for loan and lease losses is maintained at a level that Management believes is sufficient to absorb estimated probable credit losses. Note 1 Summary of Significant Accounting Policies Allowance for Loan and Lease Losses, included in the Corporation's 2007 Annual Report on Form 10K contains additional information relative to Management's determination of the adequacy of the allowance for loan and lease losses.

**Table of Contents****4. Impaired Loans and Leases**

The following summarizes the Corporation's impaired loans and leases for the periods ended:

| (dollars in thousands)                         | For The<br>Six Months Ended |                  | For The<br>Twelve Months Ended |
|--|-----------------------------|------------------|--------------------------------|
|  | June 30,<br>2008            | June 30,<br>2007 | December<br>31, 2007           |
| Period end balance                             | \$ 1,060                    | \$ 570           | \$ 574                         |
| Average period to date balance                 | 931                         | 421              | 504                            |
| Loans and leases with specific loss allowances |                             |                  |                                |
| Charge offs and recoveries                     |                             |                  | (23)                           |
| Loss allowances reserved                       |                             |                  |                                |
| Period to date income recognized               | \$ 21                       | \$ 27            | \$ 23                          |

**5. Stock Based Compensation**

The Corporation adopted FAS No. 123R Share-Based Payments ( FAS 123R ) effective January 1, 2006. FAS 123R establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock based compensation cost is measured at the grant date, based on the fair value of the award and is recognized as an expense over the vesting period. The Corporation previously applied Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations and provided the required pro forma disclosures of FAS No. 123, Accounting for Stock-Based Compensation ( FAS 123 ).

Generally, the approach in FAS 123R to stock-based payment accounting is similar to FAS 123. However, FAS 123R requires all share-based payments, including grants of stock options, be recognized as compensation cost in the statement of income at their fair value. Pro forma disclosure for periods beginning after January 1, 2006 is not an alternative under FAS 123R.

The Corporation elected to adopt FAS 123R using the modified prospective application method in which compensation cost is recognized beginning with the effective date (a) based upon the requirements of FAS 123R for all share-based payments granted after the effective date, and (b) based on the requirements of FAS 123 for all awards granted prior to the effective date of FAS 123R that remain unvested on the effective date.

The Corporation's stock-based compensation expense for the six months ended June 30, 2008 and 2007 was \$82 thousand and \$16 thousand, respectively.

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The following table provides information about options outstanding for the three-months ended June 30, 2008:

|                                    | Shares  | Weighted<br>Average<br>Exercise Price | Weighted<br>Average Grant<br>Date Fair Value |
|------------------------------------|---------|---------------------------------------|--|
| Options outstanding March 31, 2008 | 812,300 | \$ 18.76                              | \$ 4.10                                      |
| Granted                            |         |                                       |  |
| Forfeited                          | 7,000   | 21.21                                 | 4.86   |
| Exercised                          | 10,000  | 15.18                                 | 3.11   |
| Options outstanding June 30, 2008  | 795,300 | \$ 18.78                              | \$ 4.11                                      |

The following table provides information about unvested options for the three-months ended June 30, 2008:

|                                 | Shares  | Weighted<br>Average<br>Exercise Price | Weighted<br>Average Grant<br>Date Fair Value |
|---------------------------------|---------|---------------------------------------|--|
| Unvested options March 31, 2008 | 137,501 | \$ 22.08                              | \$ 5.02                                      |
| Granted                         |         |                                       |  |
| Vested                          | 1,209   | 21.83                                 | 5.90   |
| Forfeited                       |         |                                       |  |
| Unvested options June 30, 2008  | 136,292 | \$ 22.09                              | \$ 5.01                                      |

The following table provides information about options outstanding for the six months ended June 30, 2008:

|                                       | Shares  | Weighted<br>Average<br>Exercise Price | Weighted<br>Average Grant<br>Date Fair Value |
|---------------------------------------|---------|---------------------------------------|--|
| Options outstanding December 31, 2007 | 860,750 | \$ 18.52                              | \$ 4.04                                      |
| Granted                               |         |                                       |  |
| Forfeited                             | 7,000   | 21.21                                 | 4.86   |
| Exercised                             | 58,450  | 14.63                                 | 2.98   |
| Options outstanding June 30, 2008     | 795,300 | 18.78                                 | \$ 4.11                                      |

The following table provides information about unvested options for the six-months ended June 30, 2008:

|                                    | Shares  | Weighted<br>Average<br>Exercise Price | Weighted<br>Average Grant<br>Date Fair Value |
|------------------------------------|---------|---------------------------------------|--|
| Unvested options December 31, 2007 | 139,584 | \$ 22.10                              | \$ 5.04                                      |
| Granted                            |         |                                       |  |
| Vested                             | 3,292   | 22.65                                 | 6.04   |
| Forfeited                          |         |                                       |  |

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|                                |         |    |       |    |      |
|--------------------------------|---------|----|-------|----|------|
| Unvested options June 30, 2008 | 136,292 | \$ | 22.09 | \$ | 5.01 |
|--------------------------------|---------|----|-------|----|------|

The total not-yet-recognized compensation expense of unvested stock options is \$566 thousand. This expense will be recognized over a weighted average period of 50 months.

Proceeds, related tax benefits realized from options exercised and intrinsic value of options exercised during the six months ended June 30, 2008 and 2007 were as follows:

|  | 2008              | 2007              |
|--|-------------------|-------------------|
| Proceeds from strike price of value of options exercised | \$ 855,098        | \$ 792,000        |
| Related tax benefit recognized                           | 116,370           | 168,000           |
| <b>Proceeds of options exercised</b>                     | <b>\$ 971,468</b> | <b>\$ 960,000</b> |
| Intrinsic value of options exercised                     | \$ 332,488        | \$ 481,000        |



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The following table provides information about options outstanding and exercisable options at June 30, 2008:

|  | Outstanding  | Exercisable  |
|--|--------------|--------------|
| Number                                       | 795,300      | 659,008      |
| Weighted average exercise price              | \$ 18.78     | \$ 18.10     |
| Aggregate intrinsic value                    | \$ 1,283,577 | \$ 1,283,577 |
| Weighted average contractual term (in years) | 5.88         | 5.21         |

For the six months ended June 30, 2008 there were no options granted.

**6. Pension and Other Post-Retirement Benefit Plans**

The Corporation sponsors two pension plans; the qualified defined benefit pension plan ( QDBP ) and the non-qualified defined benefit pension plan ( SERP ). In addition, the Corporation also sponsors a post-retirement benefit plan ( PRBP ).

On February 12, 2008 the Corporation amended the QDBP to cease further accruals of benefits effective March 31, 2008, and amended the 401(K) Plan to provide for a new class of immediately vested discretionary, non-matching employer contributions effective April 1, 2008. Additionally, the Corporation amended the SERP to expand the class of eligible participants to include certain officers of the Bank and to provide that each participant's accrued benefit shall be reduced by the actuarially equivalent value of the immediately vested discretionary, non-matching employer contribution to the 401(K) Plan made on his or her behalf.

The following table provides a reconciliation of the components of the net periodic benefits cost (benefit) for the three months ended June 30, 2008 and 2007:

|                                       | For Three months<br>Ended June 30 |       |          |        |         |         |
|---------------------------------------|-----------------------------------|-------|----------|--------|---------|---------|
|                                       | SERP                              |       | QDBP     |        | PRBP    |         |
|                                       | 2008                              | 2007  | 2008     | 2007   | 2008    | 2007    |
| Service cost                          | \$ 16                             | \$ 20 | \$       | \$ 326 | \$      | \$ (1)  |
| Interest cost                         | 49                                | 29    | 426      | 451    | 16      | 10      |
| Expected return on plan assets        |                                   |       | (635)    | (699)  |         |         |
| Amortization of transition obligation |                                   |       |          |        | 6       | 6       |
| Amortization of prior service costs   | 33                                | 11    | 78       | 16     | (50)    | (34)    |
| Amortization of net (gain) loss       |                                   | 12    |          | 128    | 14      | (5)     |
| Net periodic benefit cost (benefit)   | \$ 98                             | \$ 72 | \$ (131) | \$ 222 | \$ (14) | \$ (24) |

The following table provides a reconciliation of the components of the net periodic benefits cost (benefit) for the six months ended June 30, 2008 and 2007:

|                                       | For Six months<br>Ended June 30 |       |         |         |       |      |
|---------------------------------------|---------------------------------|-------|---------|---------|-------|------|
|                                       | SERP                            |       | QDBP    |         | PRBP  |      |
|                                       | 2008                            | 2007  | 2008    | 2007    | 2008  | 2007 |
| Service cost                          | \$ 57                           | \$ 30 | \$ 337  | \$ 626  | \$    | \$ 2 |
| Interest cost                         | 98                              | 57    | 849     | 876     | 32    | 38   |
| Expected return on plan assets        |                                 |       | (1,315) | (1,274) |       |      |
| Amortization of transition obligation |                                 |       |         |         |       | 13   |
| Amortization of prior service costs   | 66                              | 22    | 93      | 41      | 12    | (69) |
| Amortization of net (gain) loss       |                                 | 13    |         | 228     | (100) | 29   |

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|                                     |        |        |         |        |        |       |     |
|-------------------------------------|--------|--------|---------|--------|--------|-------|-----|
| Curtailment                         |        |        |         |        | 18     |       | 28  |
| Settlement                          |        |        |         |        |        |       | 153 |
| Net periodic benefit cost (benefit) | \$ 221 | \$ 122 | \$ (18) | \$ 497 | \$ 125 | \$ 13 |     |

**QDBP:** As stated in the Corporation's 2007 Annual Report, the Corporation does not have any minimum funding requirements for its QDBP for 2008. As of June 30, 2008 no contributions have been made to the QDBP.

**SERP:** The Corporation contributed \$67 thousand during the six months ended June 30, 2008 to the SERP and it is expected to contribute an additional \$69 thousand in the second half of 2008.

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**PRBP:** In 2007 the Corporation amended the PRBP to allow for settlement obligations to certain current and retired employees. Certain retired employee obligations were settled in 2007 and current employee obligations were settled during the quarter ended March 31, 2008. The Corporation contributed \$93 thousand to the PBRP in the first six months of 2008 and expects to contribute an additional \$136 thousand for the balance of 2008.

**7. Segment Information**

FAS No. 131, Segment Reporting ( FAS 131 ), identifies operating segments as components of an enterprise which are evaluated regularly by the Corporation's Chief Executive Officer in deciding how to allocate resources and assess performance. The Corporation has applied the aggregation criterion set forth in FAS 131 to the results of its operations.

The Corporation has identified four segments as defined by FAS 131 as follows: Banking, Wealth Management, Mortgage Banking, and All Other. Footnote 23 Segment Information, in the Notes to the Consolidated Financial Statements in the Corporation.

Segment information for the quarter ended June 30, 2008 is as follows:

|   | 2008     |                   |                  |           | Consolidated |
|---|----------|-------------------|------------------|-----------|--------------|
|   | Banking  | Wealth Management | Mortgage Banking | All Other |              |
| Net interest income                                     | \$ 9,277 | \$                | \$ 25            | \$ 1      | \$ 9,303     |
| Less: Loan and lease loss provision                     | 781      |                   |                  |           | 781          |
| Net interest income after loan and lease loss provision | 8,496    |                   | 25               | 1         | 8,522        |
| Other income:   |          |                   |                  |           |              |
| Fees for wealth management services                     |          | 3,291             |                  |           | 3,291        |
| Service charges on deposit accounts                     | 429      |                   |                  |           | 429          |
| Loan servicing and other fees                           | 72       |                   | 231              | 2         | 305          |
| Net gain on sale of loans                               |          |                   | 363              |           | 363          |
| Other income  | 744      |                   | 62               | 38        | 844          |
| Total other income                                      | 1,245    | 3,291             | 656              | 40        | 5,232        |
| Other expenses:   |          |                   |                  |           |              |
| Salaries and wages                                      | 2,949    | 1,237             | 250              | 96        | 4,532        |
| Employee benefits                                       | 662      | 251               | 23               | 11        | 947          |
| Occupancy and bank premises                             | 1,156    | 112               | 58               | (46)      | 1,280        |
| Other operating expense                                 | 1,853    | 329               | 194              | (132)     | 2,244        |
| Total other expense                                     | 6,620    | 1,929             | 525              | (71)      | 9,003        |
| Segment profit before income taxes                      | 3,121    | 1,362             | 156              | 112       | 4,751        |
| Intersegment pretax revenues (expenses)*                | 201      | 45                | 10               | (256)     |              |
| Pretax segment profit (loss) after eliminations         | \$ 3,322 | \$ 1,407          | \$ 166           | \$ (144)  | \$ 4,751     |
| % of segment pretax profit (loss) after eliminations    | 69.9%    | 29.6%             | 3.5%             | (3.0%)    | 100%         |

\* Intersegment revenues consist of rental payments, insurance commissions and a management fee.

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Segment information for the quarter ended June 30, 2007 is as follows:

(Dollars in thousands)

|  | 2007     |                      |                     |              |              |
|--|----------|----------------------|---------------------|--------------|--------------|
|  | Banking  | Wealth<br>Management | Mortgage<br>Banking | All<br>Other | Consolidated |
| Net interest income                                  | \$ 8,496 | \$                   | \$ 16               | \$ 2         | \$ 8,514     |
| Less: Loan and lease loss provision                  | 240      |                      |                     |              | 240          |
| Net interest income after loan loss provision        | 8,256    |                      | 16                  | 2            | 8,274        |
| Other income:  |          |                      |                     |              |              |
| Fees for wealth management services                  |          | 3,423                |                     |              | 3,423        |
| Service charges on deposit accounts                  | 356      |                      |                     |              | 356          |
| Loan servicing and other fees                        | 14       |                      | 263                 |              | 277          |
| Net gain on sale of loans                            |          |                      | 258                 | 1            | 259          |
| Other operating income                               | 568      |                      | 136                 | 45           | 749          |
| Total other income                                   | 938      | 3,423                | 657                 | 46           | 5,064        |
| Other expenses:                                      |          |                      |                     |              |              |
| Salaries and wages                                   | 2,646    | 1,082                | 189                 | 64           | 3,981        |
| Employee benefits                                    | 804      | 211                  | 31                  | 11           | 1,057        |
| Occupancy and bank premises                          | 1,086    | 140                  | 39                  | (40)         | 1,225        |
| Other operating expense                              | 2,173    | 252                  | 151                 | (86)         | 2,490        |
| Total other expense                                  | 6,709    | 1,685                | 410                 | (51)         | 8,753        |
| Segment profit before income taxes                   | 2,485    | 1,738                | 263                 | 99           | 4,585        |
| Intersegment pretax revenues (expenses)*             | 194      | 45                   | 10                  | (249)        |              |
| Pretax segment profit (loss) after eliminations      | \$ 2,679 | \$ 1,783             | \$ 273              | \$ (150)     | \$ 4,585     |
| % of segment pretax profit (loss) after eliminations | 58.4%    | 38.9%                | 6.0%                | (3.3%)       | 100.0%       |

\* Intersegment revenues consist of rental payments, insurance commissions and a management fee.

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Segment information for the six months ended June 30, 2008 is as follows:

(Dollars in thousands)

|   | 2008      |                      |                     |              |              |
|---|-----------|----------------------|---------------------|--------------|--------------|
|   | Banking   | Wealth<br>Management | Mortgage<br>Banking | All<br>Other | Consolidated |
| Net interest income                                     | \$ 17,872 | \$                   | \$ 36               | \$ 3         | \$ 17,911    |
| Less: Loan and lease loss provision                     | 1,635     |                      |                     |              | 1,635        |
| Net interest income after loan and lease loss provision | 16,237    |                      | 36                  | 3            | 16,276       |
| Other income:   |           |                      |                     |              |              |
| Fees for wealth management services                     |           | 6,603                |                     |              | 6,603        |
| Service charges on deposit accounts                     | 821       |                      |                     |              | 821          |
| Loan servicing and other fees                           | 152       |                      | 462                 | 1            | 615          |
| Net gain on sale of loans                               |           |                      | 695                 |              | 695          |
| Other income  | 1,940     |                      | 97                  | 91           | 2,128        |
| Total other income                                      | 2,913     | 6,603                | 1,254               | 92           | 10,862       |
| Other expenses:   |           |                      |                     |              |              |
| Salaries and wages                                      | 5,900     | 2,418                | 496                 | 197          | 9,011        |
| Employee benefits                                       | 1,701     | 492                  | 63                  | 23           | 2,279        |
| Occupancy and bank premises                             | 2,317     | 246                  | 107                 | (91)         | 2,579        |
| Other operating expense                                 | 3,392     | 610                  | 432                 | (221)        | 4,213        |
| Total other expense                                     | 13,310    | 3,766                | 1,098               | (92)         | 18,082       |
| Segment profit before income taxes                      | 5,840     | 2,837                | 192                 | 187          | 9,056        |
| Intersegment pretax revenues (expenses) *               | 394       | 90                   | 20                  | (504)        |              |
| Pretax segment profit (loss) after eliminations         | \$ 6,234  | \$ 2,927             | \$ 212              | \$ (317)     | \$ 9,056     |
| % of segment pretax profit (loss) after eliminations    | 68.8%     | 32.3%                | 2.4%                | (3.5%)       | 100%         |

\* Intersegment revenues consist of rental payments, insurance commissions and a management fee.

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Segment information for the six months ended June 30, 2007 is as follows:

|  | 2007      |                   |                  |           | Consolidated |
|--|-----------|-------------------|------------------|-----------|--------------|
|  | Banking   | Wealth Management | Mortgage Banking | All Other |              |
| (Dollars in thousands)                               |           |                   |                  |           |              |
| Net interest income                                  | \$ 16,834 | \$                | \$ 52            | \$ 4      | \$ 16,890    |
| Less: Loan and lease loss provision                  | 490       |                   |                  |           | 490          |
| Net interest income after loan loss provision        | 16,344    |                   | 52               | 4         | 16,400       |
| Other income:  |           |                   |                  |           |              |
| Fees for wealth management services                  |           | 6,710             |                  |           | 6,710        |
| Service charges on deposit accounts                  | 716       |                   |                  |           | 716          |
| Loan servicing and other fees                        | 39        |                   | 518              |           | 557          |
| Net gain on sale of loans                            |           |                   | 538              | 1         | 539          |
| Net gain on sale of real estate                      | 1,333     |                   |                  |           | 1,333        |
| Other operating income                               | 1,097     |                   | 168              | 90        | 1,355        |
| Total other income                                   | 3,185     | 6,710             | 1,224            | 91        | 11,210       |
| Other expenses:                                      |           |                   |                  |           |              |
| Salaries and wages                                   | 5,327     | 2,207             | 371              | 124       | 8,029        |
| Employee benefits                                    | 1,775     | 420               | 61               | 22        | 2,278        |
| Occupancy and bank premises                          | 2,143     | 277               | 77               | (79)      | 2,418        |
| Other operating expense                              | 3,689     | 520               | 312              | (58)      | 4,463        |
| Total other expense                                  | 12,934    | 3,424             | 821              | 9         | 17,188       |
| Segment profit (loss) before income taxes            | 6,595     | 3,286             | 455              | 86        | 10,422       |
| Intersegment pretax revenues (expenses) *            | 319       | 90                | 20               | (429)     |              |
| Pretax segment profit (loss) after eliminations      | \$ 6,914  | \$ 3,376          | \$ 475           | \$ (343)  | \$ 10,422    |
| % of segment pretax profit (loss) after eliminations | 66.3%     | 32.4%             | 4.6%             | (3.3%)    | 100.0%       |

\* Intersegment revenues consist of rental payments, insurance commissions and a management fee.

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Other segment information for the quarter and year to date period ended June 30, 2008 and 2007 is as follows:

| (dollars in millions)  | June 30<br>2008 | June 30<br>2007 | December 31,<br>2007 |
|--|-----------------|-----------------|----------------------|
| <b>Wealth Management Segment:</b>                                      |                 |                 |                      |
| Brokerage Assets <sup>(1)</sup>  | \$ 89           | 85              | \$ 85                |
| Assets Under Management - Other Institutions                           |                 | 420             |                      |
| Wealth Assets Under Management and Administration                      | 2,105           | 2,213           | 2,192                |
| <b>Assets Under Management and Administration and Brokerage Assets</b> | <b>2,194</b>    | <b>2,717</b>    | <b>2,277</b>         |
| <b>Mortgage Banking Segment:</b>                                       |                 |                 |                      |
| Mortgage Loans Serviced for Others                                     | \$ 359          | 367             | \$ 357               |
| Mortgage Servicing Rights  | \$ 3            | 3               | \$ 3                 |

<sup>(1)</sup> Brokerage assets represent assets held at a registered broker dealer under a networking agreement.

**Banking Segment:** Substantially all of the assets of the Corporation and its subsidiaries are related to the Banking Segment and are reflected on the consolidated balance sheet in these financial statements.

**8. Mortgage Servicing Rights**

The following summarizes the Corporation's activity related to mortgage servicing rights (MSRs) for the six months ended June 30, 2008 and 2007:

| (dollars in thousands)  | 2008            | 2007            |
|-------------------------|-----------------|-----------------|
| Balance, January 1      | \$ 2,820        | \$ 2,883        |
| Additions               | 284             | 98              |
| Amortization            | (195)           | (169)           |
| Impairment              | (19)            |                 |
| <b>Balance, June 30</b> | <b>\$ 2,890</b> | <b>\$ 2,812</b> |
| <b>Fair value</b>       | <b>\$ 3,843</b> | <b>\$ 4,275</b> |

At June 30, 2008 key economic assumptions and the sensitivity of the current fair value of MSRs to immediate 10 and 20 percent adverse changes in those assumptions are as follows:

| (dollars in thousands)                         | June 30,<br>2008 |
|--|------------------|
| Fair value amount of MSRs                      | \$ 3,843         |
| Weighted average life (in years)               | 6.8              |
| Prepayment speeds (constant prepayment rate)*: | 13.62%           |
| Impact on fair value:                          |                  |
| 10% adverse change                             | \$ (568)         |
| 20% adverse change                             | \$ (719)         |
| Discount rate:                                 | 10.24%           |
| Impact on fair value:                          |                  |

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|                    |          |
|--------------------|----------|
| 10% adverse change | \$ (521) |
| 20% adverse change | \$ (632) |

\* Represents the weighted average prepayment rate for the life of the MSR asset.

These assumptions and sensitivities are hypothetical and should be used with caution. As the table also indicates, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the MSRs is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another, which could magnify or counteract the sensitivities.



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### **9. Capital**

The Corporation declared and paid a regular dividend of \$0.13 per share, during the second quarter of 2008. This payment totaled \$1.1 million. The Corporation's Board of Directors declared a regular quarterly dividend of \$0.14 per share payable September 1, 2008 to shareholders of record as of August 6, 2008. During the first six months of 2008, the Corporation repurchased 16,853 shares of its common stock for \$336 thousand at an average purchase price of \$19.94 per share.

### **10. Accounting for Uncertainty in Income Taxes**

The Corporation adopted FASB interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48) on January 1, 2007. As required by FIN 48, which clarifies FAS 109, the Corporation recognizes the financial statement benefit of a tax position only after determining that the Corporation would be more likely than not to sustain the position following an examination. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon settlement with the relevant tax authority. At January 1, 2007, the Corporation applied these criteria to all tax positions for which the statute of limitations remained open. There were no adjustments to retained earnings for unrecognized tax benefits as a result of the implementation of FIN 48 at adoption during 2007.

The Corporation is subject to income taxes in the United States federal jurisdiction and multiple state jurisdictions. The Corporation is no longer subject to U.S. Federal income tax examination by taxing authorities for years before 2004. The Corporation recently closed with the Internal Revenue Service an examination of the 2005 tax year. Resolution of the examination will not have any material impact to the financial position of the Corporation.

The Corporation's policy is to record interest and penalties on uncertain tax positions as income tax expense. No interest or penalties were accrued in during the first six months of 2008. There were no significant FIN48 liabilities accrued during 2007 or in the first six months of 2008.

### **11. Fair Value Measurement**

The following disclosures are made in conjunction with the initial application of FAS 157 Fair Value Measurements (FAS 157), in 2008.

FAS 157 establishes a fair value hierarchy based on the nature of data inputs for fair value determinations, under which the Corporation is required to value each asset using assumptions that market participants would utilize to value that asset. When the Corporation uses its own assumptions it is required to disclose additional information about the assumptions used and the effect of the measurement on earnings or the net change in assets for the period.

The value of the Corporation's investment securities which generally includes state and municipal securities, U.S. government agencies and mortgage backed securities are reported at fair value. These securities are valued by an independent third party. The third party's evaluations are based on market data. They utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis their pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (only obtained from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bid, offers and reference data. For certain securities, additional inputs may be used or some market inputs may not be applicable. Inputs are prioritized differently on any given day based on market conditions.

U.S. Government agencies are evaluated and priced using multi-dimensional relational models and option adjusted spreads. State and municipal securities are evaluated on a series of matrices including reported trades and material event notices. Mortgage backed securities are evaluated using matrix correlation to treasury or floating index benchmarks, prepayment speeds, monthly payment information and other benchmarks. Other investments are evaluated using a broker-quote based application, including quotes from issuers.

These investment securities are classified as available for sale.

The value of the investment portfolio is determined using three broad levels of inputs:

Level 1 Quoted prices in active markets for identical securities;

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Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active and model derived valuations whose inputs are observable or whose significant value drivers are observable.

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Level 3 Instruments whose significant value drivers are unobservable.

These levels are not necessarily an indication of the risks or liquidity associated with these investments. The following table summarizes the assets at June 30, 2008 that are recognized on the Corporation's balance sheet using fair value measurement determined based on the differing levels of input.

| Fair Value Measurement at June 30, 2008 | Total        | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---|--------------|--|---|--|
| (dollars in millions)                   |              |  |   |  |
| Cash and cash equivalents               | \$ 26.5      | \$ 26.5  | \$  | \$   |
| Investments:                            |              |  |   |  |
| U.S. government agency securities       | 15.7         |  | 15.7  |  |
| State and municipal securities          | 7.7          |  | 7.7   |  |
| Mortgage backed securities              | 77.4         |  | 77.4  |  |
| Corporate bond securities               | 10.0         |  | 10.0  |  |
| Other investments                       | 1.1          |  | 1.1   |  |
| <br>Total Fair Value Assets             | <br>\$ 138.4 | <br>\$ 26.5  | <br>\$ 111.9  | <br>\$   |

The provisions of FAS 157 related to disclosures surrounding non-financial assets and non-financial liabilities have not been applied because in February 2008, the FASB deferred the required implementation of these disclosures until 2009.

**12. Subsequent Events****Acquisition of Lau Associates**

On July 15, 2008 the Corporation completed its acquisition of JNJ Holdings, LLC; Lau Associates, LLC; and Lau Professional Services, LLC (Lau Associates) pursuant to a Membership Interest Purchase Agreement dated June 9, 2008 (Purchase Agreement). Pursuant to the Purchase Agreement, the Corporation acquired from Marigot Daze (the owner of JNJ Holdings, LLC) all of the issued and outstanding limited liability company membership interests in JNJ Holdings, LLC, a holding company that wholly owns Lau Associates, a financial planning and investment advisory firm, and Lau Professional Services, a tax preparation firm.

The Corporation paid \$3.7 million at closing on July 15, 2008. The remaining balance of the purchase price will be paid in annual installments during the period commencing on the closing date and continuing through December 31, 2011, with the amount of such annual installments to be based on pre-tax income of the acquired business during the aforementioned post-closing period. However, the total purchase price payable by the Corporation under the Purchase Agreement will be no more than \$19 million. JNJ Holdings, LLC is now a 100% owned subsidiary of the Corporation. Lau Associates had assets under management of approximately \$603 million and assets under supervision of \$156 million as of December 31, 2007.

**Subordinated Debt**

On July 30, 2008, the Bank entered into a Subordinated Note Purchase Agreement (the Agreement) with a regional commercial bank (Lender). Pursuant to the Agreement, the Lender purchased from the Bank a Subordinated Note in the aggregate principal amount of \$10 million (the Subordinated Debt), which is intended to qualify as Tier II capital. The Subordinated Note bears interest per annum at a rate equal to the three month LIBOR Rate plus 3.75%, adjusted quarterly. Interest is payable quarterly beginning on September 15, 2008. The unpaid principal balance of the Subordinated Note plus all accrued and unpaid interest is due and payable on September 15, 2018.

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The Agreement includes customary representations, warranties, covenants and events of default. The lender cannot accelerate the outstanding principal balance of the Subordinated Debt unless an event of default consisting of a bankruptcy, receivership, insolvency or dissolution has occurred and is continuing. The Bank may redeem the Subordinated Debt without premium on any interest payment date on or after September 15, 2013. The Corporation is not a guarantor of the Subordinated Debt.

### **13. New Accounting Pronouncements**

#### **FAS 157**

In September 2006, the FASB issued FAS No. 157 Fair Value Measurements ( FAS 157 ). FAS 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and requires additional disclosures about fair-value measurements. The statement applies only to fair-value measurements that are already required or permitted by other accounting standards.

FAS 157 is effective for fair-value measures already required or permitted by other standards for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Corporation adopted FAS 157 effective January 1, 2008 and has determined that the adoption of this statement did not have a material impact on its consolidated financial statements. See Note 11 Fair Value Measurement.

#### **FAS 159**

In February 2007, the FASB issued FAS No. 159 The Fair Value Option for Financial Assets and Liabilities Including an Amendment of FASB Statement No. 115 ( FAS 159 ). FAS 159 permits entities to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings without having to apply complex hedge accounting provisions.

The Corporation adopted FAS 159 effective January 1, 2008 and determined that the adoption of this statement did not have a material impact on its consolidated financial statements upon adoption.

#### **FAS 160**

In December 2007 the FASB issued FAS No. 160 Noncontrolling Interest in Consolidated Financial Statements Including an Amendment of ARB No. 51 ( FAS 160 ). FAS 160 improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary.

FAS 160 is effective as of the beginning of an entity's first fiscal year that begins on or after December 15, 2008. Early adoption is prohibited. The Corporation has not yet determined whether this statement will have a material impact on the Corporation's consolidated financial statements upon adoption.

#### **FAS 161**

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133. SFAS No. 161 amends SFAS No. 133 and its related guidance by requiring expanded disclosures about derivative instruments and hedging activities. This statement will require us to provide additional disclosure about a) how and why we use derivative instruments; b) how we account for derivative instruments and related hedged items under SFAS No. 133 and its related interpretations; and c) how derivative instruments and related hedged items effect our financial condition, financial performance, and cash flows. SFAS No. 161 does not change the accounting for derivatives under SFAS No. 133.

SFAS No. 161 will be effective for us with the fiscal year and interim periods beginning January 1, 2009, with early adoption encouraged. The Corporation has not yet determined whether this statement will have a material impact on the Corporation's consolidated financial statements upon adoption.

#### **FAS No. 141 (revised)**

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In December 2007, FASB issued FAS No. 141 (revised 2007), Business Combinations. FAS No. 141 (revised) retains the fundamental requirement of FAS 141 that the acquisition method of accounting be used for all business combinations. However, FAS No. 141 (revised) does make significant changes to the accounting for a business combination achieved in stages, the treatment of contingent consideration, transaction and restructuring costs, and other aspects of business combination accounting. FAS No. 141 (revised) will be effective with the fiscal year that begins on January 1, 2009, and will change the Corporation's accounting treatment for business combinations on a prospective basis.

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### **SAB No. 109**

In November 2007, the SEC issued SAB No. 109, *Written Loan Commitments Recorded at Fair Value Through Earnings*. SAB No. 109 supersedes SAB No. 105, *Loan Commitments Accounted for as Derivative Instruments*, and expresses the view that expected net future cash flows related to the servicing of loans should be included in the fair value measurement of all written loan commitments that are accounted for a fair value through earnings. SAB No. 109 retains the views in SAB No. 105 that internally developed intangible assets (such as client relationship intangible assets) should not be included in the fair value measurement of derivative loan commitments. SAB No. 109 became effective on January 1, 2008 and did not have a material effect on the Corporation's consolidated financial statements upon adoption.

### **SAB No. 110**

In December 2007, the SEC issued SAB No. 110, and extended, under certain circumstances, the availability of a *simplified* method for estimating the expected term of *plain vanilla* share options in accordance with SFAS No. 123 (revised). Since the Corporation does not use the *simplified* method to estimate the expected term of share options, the adoption of SAB No. 110 did not effect the Corporation's consolidated financial statements.

## **ITEM 2 Management's Discussion and Analysis of Results of Operation and Financial Condition**

### **Brief History of the Corporation**

The Bryn Mawr Trust Company (the *Bank*) received its Pennsylvania banking charter in 1889 and is a member of the Federal Reserve System. In 1986, Bryn Mawr Bank Corporation (the *Corporation*) was formed and on January 2, 1987, the Bank became a wholly-owned subsidiary of the Corporation. The Bank and Corporation are headquartered in Bryn Mawr, PA, a western suburb of Philadelphia, PA. The Corporation and its subsidiaries provide wealth management, community banking, residential mortgage lending, insurance, leasing and business banking services to its customers through eight full service branches and seven retirement community offices throughout Montgomery, Delaware and Chester counties. The Corporation trades on the NASDAQ Global Market (*NASD*) under the symbol BMTX.

The goal of the Corporation is to become the preeminent community bank and wealth management organization in the Philadelphia area.

The Corporation competes in a highly competitive market area and includes local, national and regional banks as competitors along with savings banks, credit unions, insurance companies, trust companies, registered investment advisors and mutual fund families. The Corporation and its subsidiaries are regulated by many regulatory agencies including the Securities and Exchange Committee (*SEC*), *NASD*, Federal Deposit Insurance Corporation (*FDIC*), the Federal Reserve Bank of Philadelphia and the Pennsylvania Department of Banking.

### **Results of Operations**

The following is Management's discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in its accompanying consolidated financial statements for the Corporation. The Corporation's consolidated financial condition and results of operations consist almost entirely of the Bank's financial condition and results of operations. Current performance does not guarantee, and may not be indicative of, similar performance in the future. These interim financial statements are unaudited.

### **Critical Accounting Policies, Judgments and Estimates**

The accounting and reporting policies of the Corporation and its subsidiaries conform with accounting principles generally accepted in the United States of America (US GAAP) applicable to the financial services industry. All significant inter-company transactions are eliminated in consolidation and certain reclassifications are made when necessary to conform the previous year's financial statements to the current year's presentation. In preparing the consolidated financial statements, Management is required to make estimates and assumptions that affect the reported amount of assets and liabilities as of the dates of the balance sheets and revenues and expenditures for the periods presented. Therefore, actual results could differ from these estimates.

**The allowance for loan and lease losses** involves a higher degree of judgment and complexity than other significant accounting policies. The allowance for loan and lease losses is calculated with the objective of maintaining a reserve level believed by Management to be sufficient to absorb estimated probable credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan and lease portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, expected commitment usage, the amounts and timing of expected future cash flows on impaired loans and leases, value of collateral, estimated losses on consumer loans and residential mortgages and general amounts for historical loss

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experience. The process also considers economic conditions, international events, and inherent risks in the loan and lease portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from Management estimates, additional provisions for loan and lease losses may be required that would adversely impact earnings in future periods.

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**Other significant accounting policies** are presented in Note 1 to the Corporation's audited consolidated financial statements filed as part of the 2007 Annual Report on Form 10-K and Footnotes 3, 10 and 11 to the Corporation's unaudited financial statements on pages 7 and 16 of this Form 10-Q. There have been no material changes in assumptions or estimation techniques utilized as compared to prior periods.

### **Executive Overview**

The Corporation reported second quarter 2008 diluted earnings per share of \$0.37 and net income of \$3.2 million compared to diluted earnings per share of \$0.36 and net income of \$3.1 million in the same period last year. Results in the quarter reflect an increase in net interest income from continued growth in the Bank's loan and lease portfolio and stabilization of the net interest margin offset by a higher provision for loan and lease losses and a rise in non-interest expenses partially attributable to the Corporation's new growth initiatives.

The Corporation continues to experience strong growth in the loan and lease portfolio, which was up 15.4% from a year ago, while maintaining credit quality as the Corporation's charge-off rate for the quarter was down from the first quarter, although up from the second quarter of last year when the leasing portfolio was significantly smaller. Performance of the loan and lease portfolio reflects the historically high credit quality of the Corporation's traditional borrowers and the effect of the tightening of the credit standards in the leasing portfolio, which began in the third quarter of 2007.

Consistent with the Corporation's growth, on July 15, 2008 the Corporation purchased Lau Associates, a nationally-recognized provider of family office services with approximately \$603 million in assets under management and \$156 million in assets under supervision as of December 31, 2007. These assets under management and supervision, if combined with the June 30, 2008 Wealth assets under management, administration and brokerage of \$2.2 billion, on a pro-forma basis, result in total Wealth assets under management, administration, supervision and brokerage for the Corporation of approximately \$3 billion. This acquisition should be immediately accretive. Additionally, the Corporation also secured Delaware trust powers and intends to begin those operations later in the third quarter 2008. The opening of the Chester County regional banking office in the fourth quarter, which together with the renovations recently completed at the Wayne branch, will provide two essentially new retail banking locations in affluent communities.

Return on average equity (ROE) and return on average assets (ROA) for the quarter ended June 30, 2008 were 13.65% and 1.24%, respectively. ROE was 14.66% and ROA was 1.49% for the same period last year. ROE was 12.83% and ROA was 1.23% for the first quarter of this year.

Total portfolio loans and leases at June 30, 2008 were \$853.4 million, an increase of \$113.7 million or 15.4% from \$739.7 million at June 30, 2007. Growth in the loan portfolio compared to a year ago was broad based, led by a nearly 25% increase in home equity loans and lines, a nearly 20% increase in commercial and industrial loans, as well as increases in commercial and residential mortgages. This growth was centered mostly with existing customers and prospects in the Company's immediate service area. The total loan and lease portfolio increased \$36.6 million or 4.5% from March 31, 2008. Lease balances of \$54.1 million at June 30, 2008 comprise 6.3% of total quarter end portfolio loans and leases, up from 3.9% of total portfolio loans and leases at June 30, 2007. At 6.3%, the proportion of leases to total loans and leases is unchanged from March 31, 2008.

Net charge-offs for the second quarter of 2008 were 0.23% of average loans, down from 0.31% in the first quarter of 2008. Total non-performing loans and leases at June 30, 2008 of \$1.9 million were 0.20% of period end loans and leases, up from \$1.1 million or 0.13% at March 31, 2008 and up from 0.09% at June 30, 2007. The provision for loan and lease losses in the current quarter was \$781 thousand, up from \$240 thousand in the second quarter of 2007, but down from \$854 thousand in the first quarter of 2008. A majority of the changes in the provision, net charge-offs, and non-performing loans and leases are primarily attributable to the Company's higher yielding lease portfolio. While lease charge-offs in 2008 are higher than anticipated, in the 2008 Profit Plan they are substantially offset by their positive impact on the Company's net interest income. The allowance for loan and lease losses of \$8.7 million represents 1.02% of loans and leases compared to an allowance for loan and lease losses of \$8.4 million or 1.02% of loans and leases at March 31, 2008. At June 30, 2007 the allowance for loan and lease losses was \$8.6 million or 1.16% of total portfolio loans and leases outstanding.

During the second quarter of 2008, the Corporation increased its investment securities portfolio by \$15.0 million to \$111.9 million from \$96.9 million at the end of the first quarter as part of an overall liquidity plan. The increase in the investment securities portfolio together with the strong growth in total portfolio loans and leases increased average quarterly earning assets by 23.7% to \$950.5 million in the second quarter of 2008 from \$768.2 million in the second quarter of 2007.

The second quarter of 2008 marked a second consecutive quarter of growth in interest bearing checking, money market and savings account balances, as second quarter average balances rose to \$307.2 million from \$304.7 million in the first quarter of 2008. Average second quarter 2008 non-interest bearing balances of \$143.6 million are up from first quarter 2008 average balances of \$142.5 million.



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Wholesale funding, which is defined as wholesale deposits (primarily certificates of deposit ) and borrowed funds, of \$326.3 million at June 30, 2008 was up \$92.1 million from March 31, 2008 balances of \$234.3 million, primarily due to the increase in the loan and investment portfolios discussed earlier. Wholesale funding as a percentage of total funding was 34.9% at June 30, 2008 compared to 27.0% at March 31, 2008. See page 36 Liquidity later in this document for additional discussion regarding liquidity.

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The tax equivalent net interest margin was 3.97% in the second quarter of 2008, unchanged from 3.97% in the first quarter of 2008, but down from 4.49% in the second quarter of 2007. Earning asset yields declined 41 basis points from 6.46% in the first quarter of 2008 to 6.05% in the second quarter due to the addition of lower yielding securities (when compared to loans) and the impact of the last few Federal Reserve interest rate adjustments. At the same time, total funding costs declined 56 basis points from 3.14% in the first quarter of 2008 to 2.58% in the second quarter. The higher volume of interest earning assets compared to interest bearing liabilities accounts for the 15 basis point differential between the earning asset yield decline and the interest bearing liability yield decline. The decrease in the margin to 3.97% in the second quarter of 2008 from 4.49% in the same quarter of last year is primarily due to the \$182 million or 23.7% increase in average interest earning assets that were primarily funded with higher cost wholesale funds.

Tax equivalent net interest income increased \$692 thousand to \$9.4 million in the second quarter of 2008 from \$8.7 million the first quarter of 2008 as well as from \$8.6 million in the second quarter of 2007. The increase in tax equivalent net interest income was attributable to the significant increase in average interest earning assets and a stabilization of the Company's net interest margin.

Non-interest income for the second quarter of 2008 was \$5.2 million, an increase of \$168 thousand over the \$5.1 million in the second quarter of 2007, primarily due to an increase in the fees charged for early lease terminations, an increase in the net gain on sale of loans, and an increase in service charges on deposits. Non-interest income in the second quarter of 2008 was down \$398 thousand or 7.1%, compared to the first quarter of 2008 as the first quarter benefited from a net gain on sale of investments and interest rate floor income. Second quarter 2008 wealth management revenue was \$3.3 million, essentially flat with the first quarter 2008 and down year-over-year reflecting lower stock market levels, and the loss of a significant institutional client due to a business acquisition in the fourth quarter of 2007. The Lau Associates acquisition that closed on July 15, 2008 should benefit wealth management revenues over the balance of the year.

Non-interest expense for the second quarter of 2008 was \$9.0 million, an increase of \$250 thousand or 2.9% over \$8.8 million in the second quarter of 2007, partially due to the additional salaries and wages associated with new growth initiatives. Second quarter non-interest expenses were marginally lower than in the first quarter of the year. The changes in the Corporation's qualified and non-qualified retirement plans, which were effective March 31, 2008, reduced non-interest expenses in the second quarter compared to both the first quarter of this year as well as the second quarter a year ago.

**Six Months Results**

The Corporation reported six month 2008 net income of \$6.1 million or \$0.71 diluted earnings per share, down from net income of \$7.1 million or \$0.81 diluted earnings per share for the first six months of 2007. Net income for the first half of 2007, excluding a gain on the sale of real estate related to the first quarter 2007 sale of the Corporation's Wynnewood Branch, was \$6.2 million or \$0.71 diluted earnings per share. ROE and ROA for the six months ended June 30, 2008 were 13.25% and 1.24%, respectively, compared to 17.01% (14.92% excluding the real estate gain) and 1.76% (1.54% excluding the real estate gain), respectively, for the same period last year.

The tax equivalent net interest margin was 3.97% for the six months ended June 30, 2008, down from 4.57% from the same period in 2007. The earning asset yields declined 70 basis points to 6.25% in the first six months of 2008 from 6.95% in the same period of 2007. This decline is due to the addition of lowering yielding investment securities (when compared to loans), and the impact of the 3.25% reduction in the Bank's prime rate since June 30, 2007. At the same time, total funding costs declined 33 basis points from 3.18% for the first six months of 2007 to 2.85% for the same period in 2008. The decrease in the margin to 3.97% in 2008 from 4.75% in 2007 is primarily due to the \$162 million or 21.5% increase in average interest earning assets that were primarily funded with higher cost wholesale funds.

The tax equivalent net interest income increased \$969 thousand to \$18.1 million during the first six months of 2008 from \$17.1 million during the first six months of 2007. The increase in tax equivalent net interest income was attributable to the significant increase in average interest earning assets.

Non-interest income in the first half of the year was \$10.9 million, down approximately \$348 thousand compared to first half of 2007. Non-interest income for the six month period ended June 30, 2008, excluding the \$1.3 million 2007 gain on sale of real estate, was up \$985 thousand from the first half of last year. Other operating income, BOLI income, the net gain on the sale of loans, and service charges on deposits were up in the first half of 2008. First half 2008 non-interest income also included income from the settlement of an interest rate floor contract and from the sale of investments, which the Corporation did not have in the first half of 2007.

For the six month period ended June 30, 2008, non-interest expense was \$18.1 million, up \$894 thousand or 5.2% compared to the six month period ended June 30, 2007. The increase in non-interest expense is primarily the result of the increase in salaries and wages associated with the new growth initiatives, partially offset by a reduction in professional fees and lower advertising expense.



**Table of Contents****Key Performance Ratios**

Key financial performance ratios for the three and six months ended June 30, 2008 and 2007 are shown in the table below:

|                                    | Three Months Ended<br>June 30 |         | Six Months Ended<br>June 30 |         |         |
|------------------------------------|-------------------------------|---------|-----------------------------|---------|---------|
|                                    | 2008                          | 2007    | 2008                        | 2007    | 2007*   |
| ROE                                | 13.65%                        | 14.66%  | 13.25%                      | 17.01%  | 14.92%  |
| ROA                                | 1.24%                         | 1.49%   | 1.24%                       | 1.76%   | 1.54%   |
| Efficiency ratio                   | 61.94%                        | 64.46%  | 62.85%                      | 61.17%  | 64.21%  |
| Tax equivalent net interest margin | 3.97%                         | 4.49%   | 3.97%                       | 4.57%   | 4.57%   |
| Diluted earnings per share         | \$ 0.37                       | \$ 0.36 | \$ 0.71                     | \$ 0.81 | \$ 0.71 |
| Dividend per share                 | \$ 0.13                       | \$ 0.12 | \$ 0.26                     | \$ 0.24 | \$ 0.24 |

\* Presented for the six months ended June 30, 2007 excluding the gain on sale of real estate.

|  | June 30<br>2008 | December 31<br>2007 | June 30<br>2007 |
|--|-----------------|---------------------|-----------------|
| Book Value Per Share   | \$ 10.97        | \$ 10.60            | \$ 10.11        |
| Allowance for loan and lease losses as a Percentage of Loans | 1.02%           | 1.01%               | 1.16%           |

**Reconciliation of Non-GAAP Information for the three months and six months ended June 30, 2008**

This document contains financial information determined by methods other than in accordance with generally accepted accounting principles ( GAAP ). The Corporation s Management uses these non-GAAP measures in its analysis of the Corporation s performance. These non-GAAP measures consist of adjusting net income, diluted earnings per share, ROE and the ROA determined in accordance with GAAP to exclude the effects of the real estate gain in the first quarter of 2008 (and year to date). Management believes that the presentation excluding the impact of the real estate gain in the first quarter of 2008 (and year to date) provides useful supplementation information essential to the proper understanding of the operating results of the Corporation s core business. These disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures, which may be presented by other companies.

See the table below for a reconciliation of GAAP net income, diluted earnings per share, non-interest income, return on equity, return on assets and the efficiency ratio to comparable data that excludes the gain on sale of real estate. Management believes that the presentation provides useful supplemental information essential to the proper understanding of the operating results of the Corporation s core business. These disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures, which may be presented by other companies.

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(dollars in thousands, except per share data)

| Six Months Ended June 30:                                | Net Income                 |          | Change     |            | Non-interest Income |           | Change           |            |
|--|----------------------------|----------|------------|------------|---------------------|-----------|------------------|------------|
|  | 2008                       | 2007     | Dollars    | Percentage | 2008                | 2007      | Dollars          | Percentage |
| As reported (GAAP)                                       | \$ 6,063                   | \$ 7,067 | \$ (1,004) | (14.2)%    | \$ 10,862           | \$ 11,210 | \$ (348)         | (3.1)%     |
| After-tax/ pre-tax effect of gain on sale of real estate |                            | (866)    | 866        | 11.9%      |                     | (1,333)   | 1,333            | 13.1%      |
| Adjusted (Non-GAAP)                                      | \$ 6,063                   | \$ 6,201 | \$ (138)   | (2.3)%     | \$ 10,862           | \$ 9,877  | \$ 985           | 10.0%      |
|  | Diluted Earnings Per Share |          | Change     |            | Return on Equity    |           | Return on Assets |            |
|  | 2008                       | 2007     | Dollars    | Percentage | 2008                | 2007      | 2008             | 2007       |
| As reported (GAAP)                                       | \$ 0.71                    | \$ 0.81  | \$ (0.10)  | (13.4)%    | 13.25%              | 17.01%    | 1.24%            | 1.76%      |
| After-tax/ pre-tax effect of gain on sale of real estate |                            | (0.10)   | 0.10       | 12.0%      | 0.00%               | (2.09)%   | 0.00%            | (0.22)%    |
| Adjusted (Non-GAAP)                                      | \$ 0.71                    | \$ 0.71  | \$ (0.00)  | (1.4)%     | 13.25%              | 14.92%    | 1.24%            | 1.54%      |
|  |                            |          |            |            |                     |           | Efficiency Ratio |            |
|  |                            |          |            |            |                     |           | 2008             | 2007       |
| As reported (GAAP)                                       |                            |          |            |            |                     |           | 62.85%           | 61.17%     |
| After-tax/ pre-tax effect of gain on sale of real estate |                            |          |            |            |                     |           |                  | 3.04%      |
| Adjusted (Non-GAAP)                                      |                            |          |            |            |                     |           | 62.85%           | 64.21%     |

The table below reconciles the segment pretax profit to comparable data that excludes the gain on sale of real estate. Management believes that the presentation provides useful supplemental information essential to the proper understanding of the operation results of the Corporation's segments. These disclosures should not be viewed as or substituted for operating results determined in accordance with GAAP.

(Dollars in thousands)

|  | Six Months Ended June 30, 2007 |                   |                  |           |              |
|--|--------------------------------|-------------------|------------------|-----------|--------------|
|  | Banking                        | Wealth Management | Mortgage Banking | All Other | Consolidated |
| Segment pretax profit (loss) (GAAP)  | \$ 6,914                       | \$ 3,376          | \$ 475           | \$ (343)  | \$ 10,422    |
| Segment pretax gain on sale of real estate   | (1,333)                        |                   |                  |           | (1,333)      |
| Segment pretax profit (loss) excluding gain on sale of real estate (Non-GAAP)      | \$ 5,581                       | \$ 3,376          | \$ 475           | \$ (343)  | \$ 9,089     |
| % of segment pretax profit (loss) (GAAP)   | 66.3%                          | 32.4%             | 4.6%             | (3.3%)    | 100%         |
| % of segment pretax gain on sale of real estate                                    | (4.9%)                         |                   |                  |           | 100%         |
| % of segment pretax profit (loss) excluding gain on sale of real estate (Non-GAAP) | 61.4%                          | 37.1%             | 5.2%             | (3.7%)    | 100%         |

**Components of Net Income**

Net income is affected by five major elements: **Net Interest Income** or the difference between interest income earned on loans and investments and interest expense paid on deposit and borrowed funds; the **Provision for Loan and Lease Losses** or the amount added to the allowance for

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loan and lease losses to provide reserves for inherent losses on loans and leases; **Non-Interest Income** which is made up primarily of certain fees, trust income, residential mortgage activities and gains and losses from the sale of securities; **Non-Interest Expenses** which consist primarily of salaries, employee benefits and other operating expenses; and **Income Taxes**. Each of these major elements will be reviewed in more detail in the following discussion.

**Table of Contents****NET INTEREST INCOME ON A TAX EQUIVALENT BASIS****Three Months Ended June 30, 2008 Compared to the Same Period Ended June 30, 2007**

The tax equivalent net interest income for the three months ended June 30, 2008 of \$9.4 million was \$766 thousand or 8.9% higher than the net interest income for the same period in 2007 of \$8.6 million. The analysis below indicates that increased investment and loan volume was the primary driver of the increase in net interest income. The growth in interest income was partially offset by an increase in interest expense, as the funding sources to support the increased investment and loan volume are concentrated in higher rate wholesale deposits and borrowed funds. Average earning assets increased \$182.3 million or 23.7% in the second quarter of 2008 compared to the same period in 2007.

Second quarter 2008 average loans and leases grew \$118.6 million or 16.4% while investments increased \$59.8 million or 32.1% over second quarter 2007 averages. The increase in investments is a result of the Corporation's goal to increase liquidity and Federal Home Loan Bank (FHLB) borrowing capacity, while also taking advantage of the interest rate spread of federal agency mortgage backed securities. The average earning asset yield during the second quarter of 2008 of 6.05% was 92 basis points below the 6.97% during the same period in 2007. The decrease in rates (specifically a decrease in the prime rate of 325 basis points) was the primary factor contributing to the decline. The rate paid on average interest bearing liabilities decreased 69 basis points to 2.58% in 2008 from 3.27% in the second quarter of 2007. The decrease in the rate on interest bearing deposits is due to higher rate wholesale deposits maturing and being replaced with lower cost wholesale certificates. The use of higher rate wholesale certificates of deposit has increased as funding needs have increased. Average wholesale deposits increased \$57.8 million or 69.1% in the second quarter of 2008 compared to the same period in 2007, while savings, NOW and money market accounts increased 11.4% during the same time period. Average borrowed funds increased \$102.8 million or 215.5% to \$150.6 million in the second quarter of 2008 from \$47.7 million in the second quarter of 2007. The increase in wholesale deposits and borrowed funds is a direct result of the strong loan and investment portfolio growth.

**Six Months Ended June 30, 2008 Compared to the Same Period Ended June 30, 2007**

The tax equivalent net interest income for the six months ended June 30, 2008 of \$18.1 million was \$969 thousand or 5.7% higher than the net interest income for the same period in 2007 of \$17.1 million. The analysis below indicates that the increase in investment and loan volume was the primary driver of the increase in net interest income. The growth in interest income of \$2.5 million was partially offset by an increase in interest expense of \$1.5 million, as the funding sources to support the increased investment and loan volume are concentrated in higher rate wholesale deposits and borrowed funds. Average earning assets increased \$162.9 million or 21.5% in the first six months of 2008 compared to the same period in 2007.

Year to date 2008 average loans and leases grew \$120.2 million or 17.0% while investments increased \$34.8 million or 75.4% over corresponding year to date 2007 averages. The increase in investments is the result of the Corporation's goal to increase the liquidity and FHLB borrowing capacity, while also taking advantage of the interest rate spread of federal agency mortgage backed securities. The average earning asset yield during the first six months of 2008 of 6.25% was 70 basis points below the 6.95% during the same period in 2007. The decrease in rates (specifically a decrease in the prime rate by 325 basis points) was the primary factor contributing to the decline. The rate paid on average interest bearing liabilities decreased 33 basis points to 2.85% in 2008 from 3.18% in 2007. The decrease in the rate on interest bearing deposits is due to overall decline in rates and the higher rate wholesale deposits maturing and being replaced with lower cost wholesale deposits. The use of higher rate wholesale certificates of deposit and borrowings has increased as funding needs have increased. Average wholesale deposits increased \$78.7 million or 36.2% in the first six months of 2008 compared to the same period in 2007, while savings, NOW and money market accounts increased 9.8% during the same time period. Average borrowed funds increased \$64.2 million or 145.8% to \$108.3 million in 2008 from \$44.1 million in 2007. The increase in wholesale deposits and borrowed funds is a direct result of the strong loan and investment portfolio growth.

**Table of Contents****Rate /Volume Analysis on a tax equivalent basis\***

| ((in thousands))<br>Increase/(Decrease)    | Three months Ended<br>June 30,<br>2008 Compared to 2007 |                |               | Six months Ended<br>June 30,<br>2008 Compared to 2007 |                 |               |
|--|---|----------------|---------------|---|-----------------|---------------|
|  | Volume  | Rate           | Total         | Volume  | Rate            | Total         |
| <b>Interest Income:</b>                    |   |                |               |   |                 |               |
| Interest-bearing deposits with other banks | \$ 22   | \$ (16)        | \$ 6          | \$ 91   | \$ (50)         | \$ 41         |
| Federal funds sold                         | 30  | (26)           | 4             | 92  | (62)            | 30            |
| Investment securities available for sale   | 753   | (112)          | 641           | 880   | (116)           | 764           |
| Loans and leases                           | 2,075   | (1,767)        | 308           | 4,275   | (2,639)         | 1,636         |
| <b>Total interest income</b>               | <b>2,880</b>  | <b>(1,921)</b> | <b>959</b>    | <b>5,338</b>  | <b>(2,867)</b>  | <b>2,471</b>  |
| <b>Interest expense:</b>                   |   |                |               |   |                 |               |
| Savings, NOW and market rate accounts      | \$ 110  | \$ (293)       | \$ (183)      | \$ 195  | \$ (319)        | \$ (124)      |
| Time deposits                              | (43)  | (586)          | (629)         | (697)   | (697)           | (697)         |
| Wholesale deposits                         | 779   | (320)          | 459           | 2,129   | (447)           | 1,682         |
| Borrowed funds                             | 1,385   | (839)          | 546           | 1,738   | (1,097)         | 641           |
| <b>Total interest expense</b>              | <b>2,231</b>  | <b>(2,038)</b> | <b>193</b>    | <b>4,062</b>  | <b>(2,560)</b>  | <b>1,502</b>  |
| <b>Interest differential</b>               | <b>\$ 649</b>   | <b>\$ 117</b>  | <b>\$ 766</b> | <b>\$ 1,276</b>                                       | <b>\$ (307)</b> | <b>\$ 969</b> |

\* The tax rate used in the calculation of the tax equivalent income is 35%.



**Table of Contents****Analyses of Interest Rates and Interest Differential**

The tables below presents the major asset and liability categories on an average daily basis for the periods presented, along with interest income and expense and key rates and yields.

|  | For the three months ended June 30, |                                |                                     |                    |                                |                                     |
|--|-------------------------------------|--------------------------------|-------------------------------------|--------------------|--------------------------------|-------------------------------------|
|  | 2008                                |                                |                                     | 2007               |                                |                                     |
| (dollars in thousands)                               | Average<br>Balance                  | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid | Average<br>Balance | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid |
| <b>Assets:</b>                                       |                                     |                                |                                     |                    |                                |                                     |
| Interest-bearing deposits with other banks           | \$ 2,386                            | \$ 13                          | 2.19%                               | \$ 568             | \$ 7                           | 4.94%                               |
| Federal funds sold                                   | 3,200                               | 18                             | 2.26%                               | 1,019              | 14                             | 5.51%                               |
| Investment securities available for sale:            |                                     |                                |                                     |                    |                                |                                     |
| Taxable  | 97,360                              | 1,120                          | 4.63%                               | 40,393             | 514                            | 5.10%                               |
| Tax-exempt   | 7,785                               | 94                             | 4.86%                               | 5,001              | 59                             | 4.73%                               |
| <b>Total investment securities</b>                   | <b>105,145</b>                      | <b>1,214</b>                   | <b>4.64%</b>                        | <b>45,394</b>      | <b>573</b>                     | <b>5.06%</b>                        |
| Loans and leases <sup>(1) (2)</sup>                  | 839,784                             | 13,055                         | 6.25%                               | 721,223            | 12,747                         | 7.09%                               |
| <b>Total interest earning assets</b>                 | <b>950,515</b>                      | <b>14,300</b>                  | <b>6.05%</b>                        | <b>768,204</b>     | <b>13,341</b>                  | <b>6.97%</b>                        |
| Cash and due from banks                              | 19,727                              |                                |                                     | 22,299             |                                |                                     |
| Allowance for loan and lease losses                  | (8,451)                             |                                |                                     | (8,537)            |                                |                                     |
| Other assets   | 61,352                              |                                |                                     | 47,617             |                                |                                     |
| <b>Total assets</b>                                  | <b>\$ 1,023,143</b>                 |                                |                                     | <b>\$ 829,583</b>  |                                |                                     |
| <b>Liabilities:</b>                                  |                                     |                                |                                     |                    |                                |                                     |
| Savings, NOW and market rate accounts                | \$ 307,233                          | \$ 794                         | 1.04%                               | \$ 275,777         | \$ 977                         | 1.42%                               |
| Wholesale deposits                                   | 141,459                             | 1,591                          | 4.52%                               | 83,664             | 1,132                          | 5.43%                               |
| Time deposits  | 169,562                             | 1,353                          | 3.21%                               | 173,279            | 1,982                          | 4.59%                               |
| <b>Total interest-bearing deposits</b>               | <b>618,254</b>                      | <b>3,738</b>                   | <b>2.43%</b>                        | <b>532,720</b>     | <b>4,091</b>                   | <b>3.08%</b>                        |
| Borrowed funds                                       | 150,567                             | 1,191                          | 3.18%                               | 47,720             | 645                            | 5.42%                               |
| <b>Total interest-bearing liabilities</b>            | <b>768,821</b>                      | <b>4,929</b>                   | <b>2.58%</b>                        | <b>580,440</b>     | <b>4,736</b>                   | <b>3.27%</b>                        |
| Noninterest-bearing demand deposits                  | 143,563                             |                                |                                     | 148,105            |                                |                                     |
| Other liabilities                                    | 17,531                              |                                |                                     | 16,489             |                                |                                     |
| <b>Total noninterest-bearing liabilities</b>         | <b>161,094</b>                      |                                |                                     | <b>164,594</b>     |                                |                                     |
| <b>Total liabilities</b>                             | <b>929,915</b>                      |                                |                                     | <b>745,034</b>     |                                |                                     |
| Shareholders' equity                                 | 93,228                              |                                |                                     | 84,549             |                                |                                     |
| <b>Total liabilities and shareholders' equity</b>    | <b>\$ 1,023,143</b>                 |                                |                                     | <b>\$ 829,583</b>  |                                |                                     |
| <b>Net interest spread</b>                           |                                     |                                | <b>3.47%</b>                        |                    |                                | <b>3.70%</b>                        |
| Effect of noninterest-bearing sources                |                                     |                                | 0.50%                               |                    |                                | 0.79%                               |
| <b>Net interest income/ margin on earning assets</b> |                                     | <b>\$ 9,371</b>                | <b>3.97%</b>                        |                    | <b>\$ 8,605</b>                | <b>4.49%</b>                        |

|                                  |    |    |       |    |    |       |
|----------------------------------|----|----|-------|----|----|-------|
| <b>Tax equivalent adjustment</b> | \$ | 68 | 0.03% | \$ | 91 | 0.05% |
|----------------------------------|----|----|-------|----|----|-------|

- (1) Non-accrual loans have been included in average loan balances, but interest on nonaccrual loans has not been included for purposes of determining interest income.
- (2) Loans include portfolio loans and leases and loans held for sale.

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| (dollars in thousands)                                | For the six months ended June 30, |                                |                                     |                    |                                |                                     |
|---|-----------------------------------|--------------------------------|-------------------------------------|--------------------|--------------------------------|-------------------------------------|
|   | 2008                              |                                |                                     | 2007               |                                |                                     |
|   | Average<br>Balance                | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid | Average<br>Balance | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid |
| <b>Assets:</b>  |                                   |                                |                                     |                    |                                |                                     |
| Interest-bearing deposits with other banks            | \$ 3,947                          | \$ 55                          | 2.80%                               | \$ 528             | \$ 14                          | 5.35%                               |
| Federal funds sold                                    | 5,259                             | 78                             | 2.98%                               | 1,804              | 48                             | 5.37%                               |
| Investment securities available for sale:             |                                   |                                |                                     |                    |                                |                                     |
| Taxable   | 73,305                            | 1,738                          | 4.77%                               | 41,202             | 1,043                          | 5.10%                               |
| Tax-exempt  | 7,743                             | 186                            | 4.83%                               | 5,003              | 117                            | 4.72%                               |
| <b>Total investment securities</b>                    | <b>81,048</b>                     | <b>1,924</b>                   | <b>4.77%</b>                        | <b>46,205</b>      | <b>1,160</b>                   | <b>5.06%</b>                        |
| Loans and leases <sup>(1) (2)</sup>                   | 825,184                           | 26,376                         | 6.43%                               | 705,010            | 24,740                         | 7.08%                               |
| <b>Total interest earning assets</b>                  | <b>915,438</b>                    | <b>28,433</b>                  | <b>6.25%</b>                        | <b>753,547</b>     | <b>25,962</b>                  | <b>6.95%</b>                        |
| Cash and due from banks                               | 21,017                            |                                |                                     | 23,527             |                                |                                     |
| Allowance for loan and lease losses                   | (8,315)                           |                                |                                     | (8,396)            |                                |                                     |
| Other assets  | 58,121                            |                                |                                     | 43,012             |                                |                                     |
| <b>Total assets</b>                                   | <b>\$ 986,261</b>                 |                                |                                     | <b>\$ 811,690</b>  |                                |                                     |
| <b>Liabilities:</b>                                   |                                   |                                |                                     |                    |                                |                                     |
| Savings, NOW and market rate accounts                 | \$ 305,960                        | 1,850                          | 1.22%                               | \$ 278,559         | \$ 1,974                       | 1.43%                               |
| Wholesale deposits                                    | 136,482                           | 3,236                          | 4.77%                               | 57,763             | 1,554                          | 5.43%                               |
| Time deposits   | 182,488                           | 3,469                          | 3.82%                               | 182,507            | 4,166                          | 4.60%                               |
| <b>Total interest-bearing deposits</b>                | <b>624,930</b>                    | <b>8,555</b>                   | <b>2.75%</b>                        | <b>518,829</b>     | <b>7,694</b>                   | <b>2.99%</b>                        |
| Borrowed funds  | 108,319                           | 1,828                          | 3.39%                               | 44,062             | 1,187                          | 5.43%                               |
| <b>Total interest-bearing liabilities</b>             | <b>733,249</b>                    | <b>10,383</b>                  | <b>2.85%</b>                        | <b>562,891</b>     | <b>8,881</b>                   | <b>3.18%</b>                        |
| Noninterest-bearing demand deposits                   | 143,048                           |                                |                                     | 148,759            |                                |                                     |
| Other liabilities                                     | 17,937                            |                                |                                     | 16,274             |                                |                                     |
| <b>Total noninterest-bearing liabilities</b>          | <b>160,985</b>                    |                                |                                     | <b>165,033</b>     |                                |                                     |
| <b>Total liabilities</b>                              | <b>894,234</b>                    |                                |                                     | <b>727,924</b>     |                                |                                     |
| Shareholders' equity                                  | 92,027                            |                                |                                     | 83,766             |                                |                                     |
| <b>Total liabilities and shareholders' equity</b>     | <b>\$ 986,261</b>                 |                                |                                     | <b>\$ 811,690</b>  |                                |                                     |
| <b>Net interest spread</b>                            |                                   |                                | <b>3.40%</b>                        |                    |                                | <b>3.77%</b>                        |
| Effect of noninterest-bearing sources                 |                                   |                                | .57%                                |                    |                                | 0.80%                               |
| <b>Net interest income/ margin on earning assets.</b> |                                   | <b>\$ 18,050</b>               | <b>3.97%</b>                        |                    | <b>\$ 17,081</b>               | <b>4.57%</b>                        |
| <b>Tax equivalent adjustment</b>                      |                                   | <b>\$ 139</b>                  | <b>0.04%</b>                        |                    | <b>\$ 191</b>                  | <b>.05%</b>                         |

(1) Non-accrual loans have been included in average loan balances, but interest on nonaccrual loans has not been included for purposes of determining interest income.

(2) Loans include portfolio loans and leases and loans held for sale.

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The Corporation's net interest margin decreased 52 basis points to 3.97% in the second quarter of 2008 from 4.49% in the same period last year. The yield on earning assets decreased to 6.05% in the second quarter of 2008 from 6.97% in the second quarter of 2007 as a result of the reduction in the prime rate of 325 basis points. This decrease was partially offset by the growth of higher yielding leases. Simultaneously, the cost of interest bearing liabilities decreased 69 basis points to 2.58% in the second quarter of 2008 from 3.27% in the same period last year as higher rate wholesale deposits that matured were replaced with lower cost wholesale deposits and borrowings and a commensurate decline in deposit pricing. The rates paid on deposits kept the Corporation's deposits competitive and assisted with successful deposit retention and gathering. Additionally, the volume of wholesale deposits and borrowings to fund asset growth continued to increase but at lower rates. The net interest margin in the second quarter 2008 of 3.97% was the same as the net interest margin in the first quarter of 2008. While the yield on earning assets declined there was a commensurate decline in the interest bearing liability cost. This resulted in the net interest spread increasing 15 basis points to 3.47% in the second quarter of 2008 from 3.32% in the first quarter of 2008 and a stabilization of the net interest margin.

The net interest margin and related components for the past five linked quarters are as follows:

| Year | Quarter         | Earning Asset Yield | Interest Bearing Liability Cost | Net Interest Spread | Effect of Non-Interest Bearing Sources | Net Interest Margin |
|------|-----------------|---------------------|---------------------------------|---------------------|--|---------------------|
| 2008 | 2 <sup>nd</sup> | 6.05%               | 2.58%                           | 3.47%               | 0.50%                                  | 3.97%               |
| 2008 | 1 <sup>st</sup> | 6.46%               | 3.14%                           | 3.32%               | 0.65%                                  | 3.97%               |
| 2007 | 4 <sup>th</sup> | 6.77%               | 3.43%                           | 3.34%               | 0.77%                                  | 4.11%               |
| 2007 | 3 <sup>rd</sup> | 6.95%               | 3.44%                           | 3.51%               | 0.78%                                  | 4.29%               |
| 2007 | 2 <sup>nd</sup> | 6.97%               | 3.27%                           | 3.70%               | 0.79%                                  | 4.49%               |

**Interest Rate Sensitivity**

The Corporation actively manages its interest rate sensitivity position. The objectives of interest rate risk management are to control exposure of net interest income to risks associated with interest rate movements and to achieve sustainable growth in net interest income. Management's Asset Liability Committee (ALCO), using policies and procedures approved by the Corporation's Board of Directors, is responsible for managing the interest rate sensitivity position. The Corporation manages interest rate sensitivity by changing the mix, pricing and repricing characteristics of its assets and liabilities, through the management of its investment portfolio, its offering of loan and deposit terms and through borrowings from the Federal Home Loan Bank of Pittsburgh (FHLB).

The Corporation uses several tools to manage its interest rate risk including interest rate sensitivity analysis (aka Gap Analysis), market value of portfolio equity analysis, interest rate simulations under various rate scenarios and net interest margin reports. The results of these reports are compared to limits established by the Corporation's Asset Liability Management Policies and appropriate adjustments are made if the results are outside of established limits.

The following table demonstrates the annualized result of an interest rate simulation and the expected effect that a parallel interest rate shift in the yield curve and subjective adjustments in deposit pricing might have on the Corporation's projected net interest income over the next 12 months. The changes to net interest income shown below are in compliance with the Corporation's policy guidelines.

**Summary of Interest Rate Simulation**

| (dollars in thousands)          | June 30, 2008<br>Change In Net Interest Income Over<br>Next 12 Months |         |
|---------------------------------|---|---------|
| <b>Change in Interest Rates</b> |   |         |
| +200 basis points               | \$ (74)   | (0.19)% |
| +100 basis points               | \$ (35)   | (0.09)% |
| -100 basis points               | \$ 588  | 1.51%   |
| -200 basis points               | \$ *  | *       |

\* Interest rate simulation data is not provided for a 200 basis point decline, as it is unlikely that rates would decrease 200 basis points due to the current level of rates. The federal funds rate as of June 30, 2008 was 2.00%

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The interest rate simulation above indicates that the Corporation's balance sheet as of June 30, 2008 is slightly liability sensitive meaning that an increase in interest rates should decrease net interest income and a decline in interest rates will cause an increase in net interest income over the next 12 months. The Corporation's balance sheet has changed from being slightly asset sensitive at June 30, 2007 to its current slightly liability sensitive position. The addition of fixed rate loans and the utilization of short-term wholesale funding contributed to this change.

**GAP Report**

The table below indicates that the Corporation is asset sensitive in the immediate to 90 day time frame and should experience an increase in net interest income in the near term if interest rates rise. The converse is also true. The ninety day time frame position as of June 30, 2008 is similar to the Corporation's December 31, 2007 ninety day time frame position. However, the mix of liabilities has shifted. Time deposits, in this time period, decreased due to maturing certificates which were replaced with borrowed funds. Additionally, the non-interest bearing demand balances decreased due to the short term influx of customer deposits at the end of 2007.

The following table presents the Corporation's interest rate sensitivity position or GAP Analysis as of June 30, 2008:

| (dollars in thousands)  | 0 to 90<br>Days   | 90 to 365<br>Days   | 1-5<br>Years      | Over<br>5 Years   | Non-Rate<br>Sensitive | Total               |
|---|-------------------|---------------------|-------------------|-------------------|-----------------------|---------------------|
| <b>Assets:</b>  |                   |                     |                   |                   |                       |                     |
| Interest-bearing deposits with banks  | \$ 621            | \$                  | \$                | \$                | \$                    | \$ 621              |
| Federal funds sold  |                   |                     |                   |                   |                       |                     |
| Investment securities   | 4,229             | 7,917               | 59,901            | 39,823            |                       | 111,870             |
| Loans and leases <sup>(1)</sup>   | 331,054           | 69,333              | 365,825           | 89,447            |                       | 855,659             |
| Allowance   |                   |                     |                   |                   | (8,672)               | (8,672)             |
| Cash and due from banks   |                   |                     |                   |                   | 25,901                | 25,901              |
| Other assets  |                   |                     | 144               | 500               | 63,229                | 63,873              |
| <b>Total assets</b>   | <b>\$ 335,904</b> | <b>\$ 77,250</b>    | <b>\$ 425,870</b> | <b>\$ 129,770</b> | <b>\$ 80,458</b>      | <b>\$ 1,049,252</b> |
| <b>Liabilities and shareholders' equity:</b>  |                   |                     |                   |                   |                       |                     |
| Non-interest-bearing demand   | \$ 27,164         | \$ 17,992           | \$ 95,958         | \$                | \$                    | \$ 141,114          |
| Savings, NOW and market rate  | 50,941            | 43,562              | 161,821           | 45,656            |                       | 301,980             |
| Time deposits   | 76,177            | 83,309              | 7,101             | 92                |                       | 166,679             |
| Wholesale deposits  | 22,367            | 107,358             | 14,324            |                   |                       | 144,049             |
| Borrowed funds  | 89,590            | 4,842               | 84,996            | 2,865             |                       | 182,293             |
| Other liabilities   |                   |                     |                   |                   | 19,102                | 19,102              |
| Shareholders' equity  | 3,358             | 10,075              | 53,734            | 26,868            |                       | 94,035              |
| <b>Total liabilities and shareholders' equity</b>   | <b>\$ 269,597</b> | <b>\$ 267,138</b>   | <b>\$ 417,934</b> | <b>\$ 75,481</b>  | <b>\$ 19,102</b>      | <b>\$ 1,049,252</b> |
| <b>Interest earning assets</b>  | <b>\$ 335,904</b> | <b>\$ 77,250</b>    | <b>\$ 425,726</b> | <b>\$ 129,270</b> | <b>\$</b>             | <b>\$ 968,150</b>   |
| <b>Interest bearing liabilities</b>   | <b>239,075</b>    | <b>239,071</b>      | <b>268,242</b>    | <b>48,613</b>     | <b>\$</b>             | <b>795,001</b>      |
| <b>Difference between interest earning assets and interest bearing liabilities</b>            | <b>\$ 96,829</b>  | <b>\$ (161,821)</b> | <b>\$ 157,484</b> | <b>\$ 80,657</b>  | <b>\$</b>             | <b>\$ 173,149</b>   |
| <b>Cumulative difference between interest earning assets and interest bearing liabilities</b> | <b>\$ 96,829</b>  | <b>\$ (64,992)</b>  | <b>\$ 92,492</b>  | <b>\$ 173,149</b> | <b>\$ 173,149</b>     | <b>\$ 173,149</b>   |
| <b>Cumulative earning assets as a % of cumulative interest bearing liabilities</b>            | <b>141%</b>       | <b>86%</b>          | <b>112%</b>       | <b>122%</b>       | <b>122%</b>           | <b>122%</b>         |

<sup>(1)</sup> Loans include portfolio loans and leases and loans held for sale.





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**PROVISION FOR LOAN AND LEASE LOSSES**

**General Discussion of the Allowance for Loan and Lease Losses**

The Corporation uses the allowance method of accounting for credit losses. The balance in the allowance for loan and lease losses is determined based on Management's review and evaluation of the loan portfolio in relation to past loss experience, the size and composition of the portfolio, current economic events and conditions, and other pertinent factors, including Management's assumptions as to future delinquencies, recoveries and losses.

Increases to the allowance for loan and lease losses are implemented through a corresponding provision (expense) in the Corporation's statement of income. Credit exposures deemed to be uncollectible are charged against the allowance for loan and lease losses. Recoveries of previously charged-off amounts are credited to the allowance for loan and lease losses.

While Management considers the allowance for loan and lease losses to be adequate based on information currently available, future additions to the allowance may be necessary due to changes in economic conditions or Management's assumptions as to future delinquencies, recoveries and losses and Management's intent with regard to the disposition of loans. In addition, the Pennsylvania Department of Banking and the Federal Reserve Bank of Philadelphia, as an integral part of their examination process, periodically review the Corporation's allowance for loan and lease losses.

The Corporation's allowance for loan and lease losses is the accumulation of four components that are calculated based on various independent methodologies. All components of the allowance for loan and lease losses are estimations. Management discusses these estimates earlier in this document under the heading of "Critical Accounting Policies, Judgments and Estimates". The four components are as follows:

Specific Loan Evaluation Component Includes the specific evaluation of larger classified loans and leases

Historical Charge-Off Component Applies a five year historical charge-off rate to pools of non-classified loans and leases

Additional Factors Component The loan portfolio is broken down into multiple homogenous subclassifications upon which multiple factors (such as delinquency trends, economic conditions, loan terms, and regulatory environment) are evaluated resulting in an allowance amount for each of the subclassifications. The sum of these amounts equals the Additional Factors Component.

Unallocated Component This amount represents a general reserve against all loans and leases.

**Asset Quality and Analysis of Credit Risk**

Asset quality remains strong at June 30, 2008 as nonperforming loans and leases of \$1.7 million as a percentage of total loans and leases were 20 basis points. This compares to non-performing loans and leases of \$2.0 million or 25 basis points at December 31, 2007 and non-performing loans and leases of \$0.7 million or 9 basis points at June 30, 2007. The allowance for loan and lease losses as a percentage of total loans and leases was 1.02% at June 30, 2008 compared with 1.01% at December 31, 2007 and 1.16% at June 30, 2007. The provision for loan and lease losses in the second quarter of 2008 was \$781 thousand, compared to \$240 thousand in the same period last year. The \$541 thousand increase in the provision for loan and lease losses in the second quarter of 2008 of \$781 thousand from \$240 thousand in the same period last year was primarily the result of net charge-offs in the second quarter of 2008 of \$467 thousand, primarily leasing related.

For the six months ending June 30, 2008 the provision for loan and lease losses of \$1.6 million increased \$1.1 million from \$490 thousand in the same period in 2007. The increase year to date is primarily due to the increase in the net charge-offs on the lease portfolio. For the six months ending June 30, 2008 net lease charge-offs totaled \$1.1 million. During the same period in 2007 net lease charge-offs were \$10 thousand.

At June 30, 2008 the leasing portfolio was \$54.1 million, an increase of \$28.9 million from June 30, 2007 and now represents 6.3% of total portfolio loans and leases. Leases are originated through a network of national brokers approved by the Corporation's leasing underwriters. Four of the Corporation's 50 brokers represent greater than 5% of total originations with the largest less than 7%. This network has created a portfolio that has resulted in diversity in equipment, industry and geography. Healthcare-related equipment represent the largest concentration of the

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portfolio at 18%. Customer concentration by state mirrors population concentrations with California representing 14%, New York State 8% and Texas, New Jersey, Pennsylvania and Florida each representing approximately 7%. The diversity of the lease portfolio by source, state and industry subjects the leasing portfolio to the general economic factors currently adversely impacting certain parts of the country.

Management made several lease underwriting adjustments during the third quarter of 2007 to mitigate potential losses, including the exiting of certain broker relationships and concentrating new originations in the best credit categories. It is anticipated that these adjustments may improve the overall lease portfolio performance over the next several quarters.

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The non-lease loan portfolio, comprised of commercial loans, commercial mortgages, construction loans and consumer loans and lines to customers in the Company's immediate service area, has not been significantly affected by the national economic trends experienced in other areas of the country. Real estate values have remained relatively stable compared to other parts of the country, and there has not been a significant increase in the Corporation's non-lease loan portfolio delinquency rates. Additional factors considered by management during the second quarter of 2008 were national delinquency trends in sub-prime mortgages. The Corporation has no exposure to sub-prime mortgage loans in its loan and lease portfolio.

Management has determined that the components of the allowance for loan and lease losses are adequate based on current conditions.

**Non Performing Assets and Related Ratios**

| (dollars in thousands)   | June 30,<br>2008 | December 31,<br>2007 | June 30,<br>2007 |
|--|------------------|----------------------|------------------|
| Residential mortgages  | \$ 1,011         | \$ 574               | \$ 569           |
| Commercial mortgages   |                  |                      |                  |
| Commercial loans   | 50               |                      |                  |
| Leases   | 636              | 173                  |                  |
| Non-accrual loans  | \$ 1,697         | \$ 747               | \$ 570           |
| Leases   |                  |                      | 84               |
| Consumer loans   | 8                | 1,263                | 41               |
| Loans and leases 90 days or more past due                              | 8                | 1,263                | 125              |
| Total non performing loans and leases                                  | 1,705            | 2,010                | 695              |
| Other non performing assets  | 155              |                      |                  |
| Other real estate owned ( OREO )                                       |                  |                      |                  |
| Total non performing assets  | \$ 1,860         | \$ 2,010             | \$ 695           |
| Allowance for loan and lease losses to non performing assets           | 509%             | 404.1%               | 1,238.1%         |
| Allowance for loan and lease losses to non performing loans and leases | 509%             | 404.1%               | 1,238.1%         |
| Non performing loans and leases to total portfolio loans               | 0.20%            | 0.25%                | 0.09%            |
| Allowance for loan losses to portfolio loans                           | 1.02%            | 1.01%                | 1.16%            |
| Non performing assets to assets  | 0.18%            | 0.20%                | 0.08%            |
| Period end portfolio loans   | \$ 853,355       | \$ 802,925           | \$ 739,660       |
| Average portfolio loans (quarterly average)                            | \$ 836,180       | \$ 787,059           | \$ 716,734       |
| Allowance for loan and lease losses                                    | \$ 8,672         | \$ 8,124             | \$ 8,605         |

**Table of Contents****Summary of Changes in the Allowance For Loan and Lease Losses**

| (dollars in thousands)                     | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            | Year Ended<br>December 31, |
|--|--------------------------------|------------|------------------------------|------------|----------------------------|
|  | 2008                           | 2007       | 2008                         | 2007       | 2007                       |
| Balance, beginning of period               | \$ 8,358                       | \$ 8,366   | \$ 8,124                     | \$ 8,122   | \$ 8,122                   |
| <b>Charge-offs:</b>                        |                                |            |                              |            |                            |
| Consumer                                   | (21)                           | (4)        | (38)                         | (14)       | (396)                      |
| Commercial and industrial                  |                                |            |                              |            | (41)                       |
| Real estate                                |                                |            |                              |            |                            |
| Leases                                     | (527)                          | (10)       | (1,172)                      | (10)       | (599)                      |
| Total charge-offs                          | (548)                          | (14)       | (1,209)                      | (24)       | (1,036)                    |
| <b>Recoveries:</b>                         |                                |            |                              |            |                            |
| Consumer                                   | 2                              | 13         | 6                            | 17         | 22                         |
| Commercial and industrial                  |                                |            |                              |            | 46                         |
| Real estate                                | 24                             |            | 24                           |            | 15                         |
| Leases                                     | 55                             |            | 92                           |            | 64                         |
| Total recoveries                           | 81                             | 13         | 122                          | 17         | 147                        |
| Net (charge-offs) / recoveries             | (467)                          | (1)        | (1,087)                      | (7)        | (889)                      |
| <b>Provision for loan and lease losses</b> | <b>781</b>                     | <b>240</b> | <b>1,635</b>                 | <b>490</b> | <b>891</b>                 |
| Balance, end of period                     | \$ 8,672                       | \$ 8,605   | \$ 8,672                     | \$ 8,605   | \$ 8,124                   |

**NON-INTEREST INCOME****Three months ended June 30, 2008 Compared to the Same Period Ended June 30, 2007**

Non-interest income for the second quarter of 2008 was \$5.2 million, an increase of \$168 thousand or 3.3% over the \$5.1 million in the second quarter of 2007. This increase is primarily due to increases in fees on early lease terminations of \$39 thousand, an increase in the net gain on the sale of loans of \$103 thousand and an increase in service charges on deposits of \$73 thousand. Wealth Management revenue of \$3.3 million in the second quarter was \$132 thousand or 3.8% lower than the same period in 2007. This includes fees from trust administration, investment management, custody and estates. The loss of fees from a significant institutional client in the fourth quarter of 2007, combined with the reduction in fees from estate settlements, and the decline of wealth assets under management of \$86.4 million, from December 31, 2007 to June 30, 2008, were partially offset by the impact of the fourth quarter 2007 minimum fee increase and new account generation in the second quarter of 2008. The decline in wealth assets under management and administration is attributed to the lower stock market values in the second quarter of 2008. Additionally, brokerage fees increased \$30 thousand in the second quarter of 2008 compared to the same period in 2007, due in part to the increase in brokerage assets to \$88.9 million at June 30, 2008 from \$85.3 million at December 31, 2007. Non-interest income from residential mortgage operations, fees from loan servicing and late fees and income on Bank owned life insurance in the second quarter of 2008 were all higher than second quarter 2007 amounts.

On July 1, 2008 the Corporation requested its BOLI insurance carrier to re-allocate the underlying BOLI investment (separate account BOLI) from an actively managed mortgaged-backed securities fund into a money market fund. Until, at such time, the Corporation, in coordination with its insurance carrier, re-allocates out of the money market fund into a higher yielding investment, it is estimated that BOLI income will be reduced to zero.

**Six months ended June 30, 2008 Compared to the Same Period Ended June 30, 2007**

Non-interest income for the six months ended June 30, 2008 was \$10.9 million, an increase of \$985 thousand or 10.0% over the \$9.9 million for the six month ended June 30, 2008 after the exclusion of the \$1.3 million (pre-tax) real estate gain. Factors contributing to this increase in non-interest income include revenue from a May 2007 BOLI investment, first quarter 2008 investment security gains and the settlement of an interest rate floor contract in the first quarter of 2008. Wealth Management revenue for the six months ended June 30, 2008 of \$6.6 million was

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\$107 thousand or 1.6% below the same period in 2007. Wealth Management revenues, excluding brokerage fees, for the first six months of 2008 were \$166 thousand or 2.5% below the same period in 2007. This includes fees from trust administration, investment management, custody and estates. The loss of fees from a significant institutional client in the fourth quarter of 2007, combined with the reduction in fees from estate settlements, and the decline of wealth assets under management of \$107.1 million, from June 30, 2007 to June 30, 2008, were partially offset by the impact of the fourth quarter 2007 minimum fee increase and new account generation in the first quarter of 2008. The decline in wealth assets under management and administration is attributed to the lower stock market values for the first six months of 2008. Additionally, brokerage fees increased \$59 thousand in the first six months of 2008 compared to the same period in 2007. Non-interest income from residential mortgage operations, fees from loan servicing and late fees and service charges on deposit accounts in the first six months of 2008 were all higher than the same period in 2007 amounts.

**Table of Contents****NON-INTEREST EXPENSE****Three months ended June 30, 2008 Compared to the Same Period Ended June 30, 2007**

Non-interest expense for the second quarter of 2008 was \$9.0 million, an increase of \$250 thousand or 2.9% over \$8.8 million in the second quarter of 2007. The primary reason for this increase is the additional staffing and benefit costs relating to the Corporation's 2006/2007 initiatives. Also contributing to the increase is higher FDIC insurance costs, as a one time credit issued to banks in existence prior to 1997 was exhausted during the first quarter of 2008. FDIC expense for the second quarter of 2008 was \$123 thousand an increase of \$101 thousand from the same period in 2007. Amortization of mortgage servicing rights for the second quarter includes a recovery of \$30 thousand of impairment that was expensed in the first quarter of 2008, relating to higher rate serviced mortgages. The freeze of the Corporation's qualified defined benefit pension plan which was announced earlier this year was effective March 31, 2008 and resulted in reduced pension costs in the second quarter of 2008.

**Six months ended June 30, 2008 Compared to the Same Period Ended June 30, 2007**

Non-interest expense for the six months ended June 30, 2008 was \$18.1 million, an increase of \$894 thousand or 5.2% compared to \$17.2 million for the same period in 2007. The primary reason for this increase is the additional staffing and benefit costs relating to the Corporation's 2006/2007 initiatives. This increase is being partially offset by a reduction in professional fees and lower advertising expense. Also contributing to the increase was higher FDIC insurance costs of \$213 thousand, an increase of \$173 thousand from the same period in 2007, as a one time credit issued to banks in existence prior to 1997 was exhausted during the first quarter of 2008.

**INCOME TAXES**

Income taxes for the three months ended June 30, 2008 were \$1.6 million compared to \$1.5 million for the same period in 2007. This represents an effective tax rate for the three months ended June 30, 2008 of 33.4% and an effective tax rate of 32.6% for the same period in 2007. Income taxes for the six months ended June 30, 2008 were \$3.0 million compared to \$3.4 million for the same period in 2007. This represents an effective tax rate for the six months ended June 30, 2008 of 33.0% compared to an effective tax rate of 32.2% for the same period in 2007. The increase in the effective tax rate is due to a reduction in the percentage of tax-free income relative to pre-tax income and additional state income taxes relating to the leasing company.

**BALANCE SHEET ANALYSIS**

Total assets increased \$47.2 million or 4.7% from \$1,002.1 million as of December 31, 2007 to \$1,049.3 million as of June 30, 2008. This increase is related to an increase in portfolio loans and leases of \$50.4 million from December 31, 2007 to June 30, 2008. Additionally, an increase in investment securities of \$63.5 million to \$111.9 million as of June 30, 2008 from \$48.4 million as of December 31, 2007 related to the Corporation's liquidity strategy. Partially offsetting the increase in portfolio loans and leases and investments is a decrease in cash and cash equivalents of \$51.1 million or 66.3% from \$77.0 million at December 31, 2007 to \$25.9 million at June 30, 2008. The decrease in cash and cash equivalents is due to short-term inflows of certain deposit accounts at year end 2007. Average portfolio loans and leases for the second quarter of 2008 increased \$29.8 million or 3.7% to \$836.2 million compared to \$806.4 million in the first quarter of 2008.

The table below compares portfolio loans and leases outstanding at June 30, 2008 and December 31, 2007. The increases in home equity lines and loans of \$15.1 million, commercial and industrial loans of \$15.0 million and in commercial mortgage loans of \$17.1 million are the primary drivers for the increase in total loans and leases of \$50.4 million. The Corporation continues to focus its business development efforts on building banking relationships with privately held businesses, non-profits, high quality residential builders and owners of commercial real estate.

Total portfolio loans outstanding are detailed by category as follows:

| (dollars in millions)       | June 30,   | December 31, | Change    |            |
|-----------------------------|------------|--------------|-----------|------------|
|                             | 2008       | 2007         | Dollars   | Percentage |
| Real estate loans:          |            |              |           |            |
| Commercial mortgage loans   | \$ 241,597 | \$ 224,510   | \$ 17,087 | 7.6%       |
| Home equity lines and loans | 138,445    | 123,293      | 15,152    | 12.3%      |
| Residential mortgage loans  | 114,924    | 121,313      | (6,389)   | -5.3%      |
| Construction loans          | 66,861     | 66,901       | (40)      | -0.1%      |

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|  |                   |                   |                  |             |
|--|-------------------|-------------------|------------------|-------------|
| Commercial and industrial loans              | 228,810           | 213,834           | 14,976           | 7.0%        |
| Consumer loans                               | 8,574             | 7,990             | 584              | 7.3%        |
| Leases                                       | 54,144            | 45,084            | 9,060            | 20.1%       |
| <b>Total portfolio loans and leases</b>      | <b>\$ 853,355</b> | <b>\$ 802,925</b> | <b>\$ 50,430</b> | <b>4.5%</b> |
| Quarterly average portfolio loans and leases | \$ 836,180        | \$ 787,059        | \$ 49,121        | 6.2%        |

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Total liabilities increased \$43.5 million from \$911.7 million at December 31, 2007 to \$955.2 million at June 30, 2008. This change is driven by an increase in borrowed funds of \$137.3 million over the past six months, partially offset by a decline in deposits of \$95.7 million. The decrease in deposits is mainly due to maturing of non-wholesale time deposits which were replaced with more favorably priced borrowings. Wholesale deposits increased \$14.2 million from \$129.8 million at December 31, 2007 to \$144.0 million at June 30, 2008. Borrowed funds increased \$137.3 million from \$45 million at December 31, 2007 to \$182.3 million at June 30, 2008. Wholesale deposits and borrowings are being utilized to offset the decline in time deposit products which is a result of the competitive environment for gathering and retaining deposits. Time deposits decreased \$36.9 million to \$166.7 million at June 30, 2008 from \$203.5 million at December 31, 2007. NOW, money market and savings accounts all increased from December 31, 2007 to June 30, 2008. The decrease in non-interest bearing demand accounts for the six month time period ending June 30, 2007, is due to a short term influx of customer deposits at the end of 2007. The average non-interest bearing demand accounts for the six months ended June 30, 2008 was \$143.6 million.

Average deposits for the second quarter of 2008 increased \$4.2 million or 0.6% to \$761.8 million compared to \$757.6 million in the fourth quarter of 2007.

Deposits and borrowings at June 30, 2008 and December 31, 2007 are as follows:

| (dollars in millions)                     | June 30,   | December 31, | Change      |            |
|---|------------|--------------|-------------|------------|
|   | 2008       | 2007         | Dollars     | Percentage |
| Non-interest bearing demand               | \$ 141,114 | \$ 228,269   | \$ (87,155) | -38.2%     |
| Savings, NOW and market rate accounts     | 301,980    | 287,977      | 14,003      | 4.9%       |
| Non-wholesale time deposits               | 166,679    | 203,462      | (36,783)    | -18.1%     |
| Time deposits from brokers and CDARS*     | 84,049     | 69,820       | 14,229      | 20.4%      |
| Time deposits from public fund sources    | 60,000     | 60,000       |             | %          |
| Total deposits                            | 753,822    | 849,528      | (95,706)    | -11.3%     |
| Fed funds purchased                       | 33,000     |              | 33,000      | 33,000%    |
| FHLB advances                             | 149,293    | 45,000       | 104,293     | 231.8%     |
| Borrowed funds                            | 182,293    | 45,000       | 137,293     | 305.1%     |
| Total deposits and borrowings             | \$ 936,115 | \$ 894,528   | \$ 41,587   | 4.6%       |
| Quarterly average deposits                | \$ 761,817 | \$ 757,583   | \$ 4,234    | 0.6%       |
| Quarterly average borrowings              | 150,567    | 44,592       | 105,975     | 237.7%     |
| Quarterly average deposits and borrowings | \$ 912,384 | \$ 802,175   | \$ 110,209  | 13.7%      |

\* CDARS -A nationwide network of domestic financial institutions operated by Promontory Interfinancial Network, LLC trading as CDARS . The Corporation uses CDARS as a wholesale funding and liquidity management tool.



**Table of Contents****Residential Mortgage Segment Activity**

| (dollars in thousands)                 | 2 <sup>nd</sup> Qtr<br>2008 | 1 <sup>st</sup> Qtr<br>2008 | 4 <sup>th</sup> Qtr<br>2007 | 3 <sup>rd</sup> Qtr<br>2007 | 2 <sup>nd</sup> Qtr<br>2007 |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Residential loans held in portfolio ** | \$ 114,924                  | \$ 118,117                  | \$ 121,313                  | \$ 113,705                  | \$ 105,441                  |
| Mortgage originations                  | 31,594                      | 28,780                      | 34,565                      | 37,285                      | 27,490                      |
| Mortgage loans sold:                   |                             |                             |                             |                             |                             |
| Servicing retained                     | 12,642                      | 14,294                      | 8,583                       | 7,588                       | 3,298                       |
| Servicing released                     | 10,149                      | 11,058                      | 12,852                      | 17,249                      | 19,521                      |
| Total mortgage loans sold              | \$ 22,791                   | \$ 25,352                   | \$ 21,435                   | \$ 24,837                   | \$ 22,819                   |
| Servicing retained %                   | 55.5%                       | 56.4%                       | 40.0%                       | 30.6%                       | 14.5%                       |
| Servicing released %                   | 44.5%                       | 43.6%                       | 60.0%                       | 69.4%                       | 85.5%                       |
| Loans serviced for others **           | \$ 358,802                  | \$ 357,734                  | \$ 357,363                  | \$ 364,684                  | \$ 367,087                  |
| Mortgage servicing rights **           | 2,890                       | 2,835                       | 2,820                       | 2,812                       | 2,812                       |
| Gain on sale of loans                  | 363                         | 332                         | 353                         | 358                         | 259                         |
| Loan servicing and late fees           | 305                         | 310                         | 282                         | 276                         | 277                         |
| Amortization of MSRs                   | 89                          | 125                         | 91                          | 88                          | 77                          |
| Basis point yield on loans sold        | 159bp                       | 131bp                       | 165bp                       | 144bp                       | 114bp                       |

\*\* *period end balance***Capital**

Consolidated shareholder's equity of the Corporation was \$94.0 million or 8.96% of total assets, as of June 30, 2008, compared to \$90.4 million or 9.02% of total assets, as of December 31, 2007. The following table presents the Corporation's and Bank's capital ratios and the minimum capital requirements to be considered Well Capitalized by regulators as of June 30, 2008 and December 31, 2007:

|  | Ratio  | Minimum Ratio<br>to be Well Capitalized |
|--|--------|---|
| <b>June 30, 2008:</b>  |        |   |
| Total (Tier II) Capital to Risk Weighted Assets                          |        |   |
| Consolidated   | 10.94% | 10.00%                                  |
| Bank   | 10.32% | 10.00%                                  |
| Tier I Capital to Risk Weighted Assets                                   |        |   |
| Consolidated   | 10.05% | 6.00%                                   |
| Bank   | 9.43%  | 6.00%                                   |
| Tier I Leverage Ratio (Tier I Capital to Total Quarterly Average Assets) |        |   |
| Consolidated   | 9.70%  | 5.00%                                   |
| Bank   | 9.09%  | 5.00%                                   |
| <b>December 31, 2007:</b>  |        |   |
| Total (Tier II) Capital to Risk Weighted Assets                          |        |   |
| Consolidated   | 11.31% | 10.00%                                  |
| Bank   | 10.72% | 10.00%                                  |
| Tier I Capital to Risk Weighted Assets                                   |        |   |
| Consolidated   | 10.40% | 6.00%                                   |
| Bank   | 9.81%  | 6.00%                                   |
| Tier I Leverage Ratio (Tier I Capital to Total Quarterly Average Assets) |        |   |
| Consolidated   | 10.42% | 5.00%                                   |
| Bank   | 9.83%  | 5.00%                                   |

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Both the Corporation and the Bank exceed the required capital levels to be considered "Well Capitalized" by their respective regulators at the end of each period presented. Neither the Corporation nor the Bank are under any agreement with regulatory authorities, nor is Management aware of any current recommendations by the regulatory authorities, which, if such recommendations were implemented, would have a material effect on liquidity, capital resources or operations of the Corporation.

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The Corporation and Bank, while classified as well capitalized, have seen capital ratios, specifically the Tier II capital ratios, decline over the last 30 months directly attributed to strong loan and investment growth during the same time period. As of June 30, 2008 the Tier II capital ratios for the Corporation and Bank were 10.94% and 10.32% respectively, compared to the 10% regulatory standard to be considered well capitalized. The addition of intangible assets related to the third quarter acquisition of Lau Associates will put additional downward pressure on the Tier II capital ratios. Accordingly, the Corporation is evaluating its options, including the reduction of new loan and lease production, loan sales, loan participations and/or the issuance of subordinated debt which should qualify as Tier II capital. In addition, the Corporation temporarily discontinued its stock buy back program on May 20, 2008. See Note 12 Subsequent Events Subordinated Debt on page 17 in the Notes to the accompanying unaudited financial statements for additional information.

**Liquidity**

The Corporation manages its liquidity position on a daily basis as part of the daily settlement function and continuously as part of the formal asset liability management process. The Bank's liquidity is maintained by managing its core deposits as the primary source, and purchasing federal funds, selling loans in the secondary market, borrowing from the FHLB, purchasing wholesale certificates of deposit and selling securities as its secondary sources. Unused availability with the FHLB was approximately \$117.8 million as of June 30, 2008 compared to \$263.0 million as of December 31, 2007. Overnight Fed Funds lines consist of lines from eight banks totaling \$70.0 million. Quarterly, Asset Liability Committee (ALCO) reviews the Corporation's liquidity needs and reports its findings to the Risk Management Committee of the Bank's Board of Directors. As of June 30, 2008, the Bank had \$149.3 million in FHLB advances. The FHLB adjusted the calculation of the maximum borrowing capacity (MBC) for all member banks effective May 6, 2008. The Corporation's MBC is \$370.1 million as of June 30, 2008.

Wholesale funding, which is defined as wholesale deposits (primarily certificates of deposit) and borrowed funds, of \$326.3 million at June 30, 2008 increased \$151.5 million or 86.7% from year end 2007 balances of \$174.8 million, primarily due to the increase in the investment and loan and lease portfolios discussed earlier. Wholesale funding as a percentage of total funding was 34.9% at June 30, 2008 compared to 19.5% at December 31, 2007.

The Corporation's investment portfolio increased to \$111.9 million at June 30, 2008 from \$48.4 million at December 31, 2007. This increase will serve to improve liquidity and provide the Corporation the opportunity to utilize the securities to borrow additional funds through the FHLB or through repurchase agreements.

As discussed above, the Corporation's reliance on wholesale funding has increased significantly over the last thirty months due mainly to the increase in the loan and lease and investments portfolios. The Corporation is evaluating alternative funding sources and different options for increasing core deposits. In the absence of adequate new funding sources, the Corporation may reduce asset growth on a go-forward basis, consider selling certain loans and/or participate portions of current and future loan transactions.

On February 27, 2008 the Corporation signed an Agreement with Promotory Interfinancial Network, LLC to provide up to \$20 million of insured network deposits (IND) priced at the Federal Funds rate plus 20 basis points. Approximately \$3.5 million in balances at June 30, 2008 under this program were included in the money market accounts.

**Off Balance Sheet Risk**

The Corporation 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 standby letters of credit.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. Total commitments to extend credit at June 30, 2008 were \$315.8 million.

Standby letters of credit are conditional commitments issued by the Bank to a customer for a third party. Such standby letters of credit are issued to support private borrowing arrangements. The credit risk involved in issuing standby letters of credit is similar to that involved in granting loan facilities to customers. The Corporation's obligation under standby letters of credit at June 30, 2008 amounted to \$18.0 million.

Estimated fair values of the Corporation's off-balance sheet instruments are based on fees and rates currently charged to enter into similar loan agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. Since fees and rates charged for off-balance sheet items are at market levels when set, there is no material difference between the stated amount and the estimated fair value of off-balance sheet instruments.



**Table of Contents****Contractual Cash Obligations of the Corporation as of June 30, 2008:**

| (In thousands)                          | Total      | Within 1<br>Year | 2-3<br>Years | 4-5<br>Years | After 5<br>Years |
|---|------------|------------------|--------------|--------------|------------------|
| Deposits without a stated maturity      | \$ 443,094 | \$ 443,094       |              |              |                  |
| Wholesale and time deposits             | 310,728    | 289,211          | 15,981       | 5,444        | 92               |
| Operating leases                        | 19,640     | 900              | 1,809        | 1,790        | 15,141           |
| Purchase obligations                    | 3,329      | 1,876            | 1,313        | 140          |                  |
| Non-discretionary pension contributions |            |                  |              |              |                  |
| Total                                   | \$ 776,741 | \$ 735,081       | \$ 19,103    | \$ 7,374     | \$ 15,233        |

**Section 404 of Sarbanes Oxley Act of 2002**

The Corporation and its Management completed compliance procedures relating to Section 404 of the Sarbanes Oxley Act of 2002 ( SOX 404 ) for the fiscal year ended December 31, 2007 as documented in the Corporation's Form 10-K. Management continues to devote considerable effort in 2008 to assure continued compliance with all aspects of SOX 404.

The PCAOB and SEC have issued management standards pertaining to management's evaluation of controls over financial reporting, along with a new auditing standard. The Corporation will continue to evaluate the new standards to determine the impact. It is anticipated that the changes may provide some opportunities to improve efficiencies and reduce compliance costs.

**Other Information****Branch Office Expansion**

In January of 2007, the Corporation's Wynnewood branch was closed and customer accounts were transferred to the new Ardmore branch office. As discussed earlier, the Wynnewood branch real estate was sold during the first quarter of 2007. The Corporation anticipates the construction of the West Chester, PA branch site will be completed by November 2008 with the opening targeted for December 2008. Major renovations to the Wayne, PA branch were completed in June 2008. The Corporation anticipates measured expansion of its branch footprint over the next few years.

**Regulatory Matters and Pending Legislation**

Management is not aware of any other current specific recommendations by regulatory authorities or proposed legislation which, if they were implemented, would have a material adverse effect upon the liquidity, capital resources, or results of operations, although the general cost of compliance with numerous and multiple federal and state laws and regulations does have, and in the future may have, an impact on the Corporation's results of operations.

In February 2006, Congress passed the Federal Deposit Insurance Reform Act of 2005 (FDIRA-2005). This legislation will merge the Bank Insurance Fund and the Savings Association Insurance Fund into one fund, increase insurance coverage for retirement accounts to \$250,000, adjust the maximum deposit insurance for inflation after March 31, 2010 and give the FDIC greater flexibility in setting insurance assessments. As part of the FDIRA-2005, the Corporation's primary operating subsidiary, the Bank, was granted a one-time credit of \$409 thousand for utilization against future FDIC assessments. The FDIC announced that 2007 and 2008 assessments will range from 5 to 7 basis points for well capitalized institutions with composite regulatory examination ratings of one or two. The Corporation's \$409 thousand credit offset all of the 2007 premium assessment and a portion of the first quarter 2008 assessment. The actual assessment for the second quarter of 2008 was \$123 thousand or the equivalent of 5 basis points annually.

Effects of Inflation

Inflation has some impact on the Corporation's operating costs. Unlike many industrial companies, however, substantially all of the Corporation's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Corporation's performance than the general level of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as prices of goods and services.

Effect of Government Monetary Policies

The earnings of the Corporation are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. An important function of the Federal Reserve Board is to regulate the money supply and interest rates. Among the instruments used to implement those objectives are open market operations in United States government securities and changes in reserve requirements against member bank deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, investments, and deposits, and their use may also affect rates charged on loans or paid for deposits.

The Corporation is a member of the Federal Reserve System and, therefore, the policies and regulations of the Federal Reserve Board have a significant effect on its deposits, loans and investment growth, as well as the rate of interest earned and paid, and are expected to affect the Corporation's operations in the future. The effect of such policies and regulations upon the future business and earnings of the Corporation cannot be predicted.

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**Special Cautionary Notice Regarding Forward Looking Statements** Certain of the statements contained in this Report and the documents incorporated by reference herein, may constitute forward-looking statements for the purposes of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended, and may involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements of the Corporation to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements include statements with respect to the Corporation's financial goals, business plans, business prospects, credit quality, credit risk, reserve adequacy, liquidity, origination and sale of residential mortgage loans, impairment of goodwill, the effect of changes in accounting standards, and market and pricing trends. The words "expect, anticipate, intended, plan, believe, seek, estimate, and similar expressions are intended to identify such forward-looking statements. The Corporation's actual results may differ materially from the results anticipated by the forward-looking statement due to a variety of factors, including without limitation:

the effect of future economic conditions on the Corporation and its customers, including economic factors which affect consumer confidence in the securities markets, wealth creation, investment and savings patterns, and the Corporation's interest rate risk exposure and credit risk;

changes in the securities markets with respect to the market values of financial assets and the stability of particular securities markets;

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

changes in accounting requirements or interpretations;

changes in laws, regulatory guidance or legislation in income and non-income taxes;

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

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

any extraordinary event;

the Corporation's success in continuing to generate new business in its existing markets, as well as its success in identifying and penetrating targeted markets and generating a profit in those markets in a reasonable time;

the Corporation's ability to continue to generate investment results for customers and the ability to continue to develop investment products in a manner that meets customers needs;

the Corporation's timely development of competitive new products and services in a changing environment and the acceptance of such products and services by customers;

the Corporation's ability to originate and sell residential mortgage loans;

the accuracy of assumptions underlying the establishment of reserves for loan and lease losses and estimates in the value of collateral, and various financial assets and liabilities;

technological changes being more difficult or expensive than anticipated; and

the Corporation's success in managing the risks involved in the foregoing.

All written or oral forward-looking statements attributed to the Corporation are expressly qualified in their entirety by use of the foregoing cautionary statements. All forward-looking statements included in this Report are based upon information presently available, and the Corporation assumes no obligation to update any forward-looking statement.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS**

There has been no material change in the Corporation's assessment of its sensitivity to market risks since its presentation in the 2006 Annual Report on Form 10-K filed with the SEC.

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of this period covered by the report, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer, Frederick C. Peters II, and Chief Financial Officer, J. Duncan Smith, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Chief Executive Officer



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and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures are effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in the Corporation's periodic SEC filings.

There have not been any changes in the Corporation's internal controls over financial reporting during the quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

**PART II OTHER INFORMATION.**

**ITEM 1. Legal Proceedings.**

None.

**ITEM 1A. Risk Factors.**

The following risk factors relating to the Corporation's ability to obtain sufficient funding to support earning asset growth and capital constraints should be considered in addition to the risk factors disclosed in the Corporation's 2007 Annual Report on Form 10-K.

**Sufficient Funding to Support Earning Asset Growth**

Over the past 30 months, the Corporation's earning assets have grown from \$730 million at December 31, 2006 to \$966 million at June 30, 2008. This growth has been funded with various forms of wholesale funding which is defined as wholesale deposits (primarily certificates of deposit) and borrowed funds. Wholesale funding at June 30, 2008 represents approximately 35.0% of total funding compared with approximately 5.0% at June 30, 2006. Wholesale funding generally costs more than deposits generated from the Corporation's traditional branch system and is subject to certain practical limits such as the FHLB's Maximum Borrowing Capacity and the Corporation's liquidity targets. Additionally, regulators might consider wholesale funding beyond certain points to be imprudent and might suggest that future asset growth be reduced or halted.

The Corporation recognizes the need to grow both wholesale and non-wholesale funding sources to support earning asset growth and to provide appropriate liquidity. In the absence of additional funding sources, the Corporation might need to reduce earning asset growth through the reduction of current production, sale of assets, and/or the participating out of future and current loans or leases. This in turn might reduce future net income of the Corporation.

**Capital Restraints**

The Corporation and Bank, while considered well capitalized for regulatory capital purposes, have seen capital ratios, specifically the Tier II capital ratios, decline over the last 30 months directly attributed to strong loan and investment growth during the same time period. As of June 30, 2008 the Tier II capital ratios for the Corporation and Bank were 10.94% and 10.32% respectively, compared to the 10% regulatory standard to be considered well capitalized. At December 31, 2006 these same ratios were 12.42% and 11.56%, respectively. The addition of intangible assets related to the third quarter 2008 acquisition of Lau Associates will put additional downward pressure on the Tier II capital ratios. Accordingly, the Corporation is evaluating its options, including the reduction of new loan and lease production, loan sales, loan participations, the issuance of subordinated debt which should qualify as Tier II capital, and/or the discontinuance of its stock buy back program. The reduction of earning asset growth might reduce future net income growth. Additionally, issuance of additional capital instruments may result in additional interest payments and/or dividends and may also dilute current shareholder's investment in the Corporation.

**Table of Contents****ITEM 2.**

The following tables present the shares repurchased by the Corporation during the second quarter of 2008 <sup>(1) (2)</sup>:

| Period                         | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plan or Programs |
|--------------------------------|----------------------------------|------------------------------|--|---|
| April 1, 2008 - April 30, 2008 | 6,442                            | \$ 21.25                     | 2,060  | 199,365   |
| May 1, 2008 - May 31, 2008     | 3,202                            | \$ 20.43                     | 2,546  | 146,920   |
| June 1, 2008 - June 30, 2008   | 2,747                            | \$ 19.86                     | 1,115  | 195,705   |
| Total                          | 12,391                           | \$ 20.72                     | 5,721  | 195,705   |

Notes to this table:

- (1) On February 24, 2006, the Board of Directors of the Corporation adopted a new stock repurchase program (the 2006 Program) under which the Corporation may repurchase up to 450,000 shares of the Corporation's common stock, not to exceed \$10 million and terminated the 2003 Program. The 2006 Program was publicly announced in a Press Release dated February 24, 2006. There is no expiration date on the 2006 Program and the Corporation has no plans for an early termination of the 2006 Program. All shares purchased through the 2006 Program were accomplished in open market transactions.
- (2) In April, May and June 2008, 4,382, 656 and 1,632 shares, respectively, were purchased by the Corporation's Thrift Plan and Deferred Compensation plans through open market transactions by the Corporation's Wealth Management Division investment personnel. On April 30, 2008 the Corporation paid its non-management directors their annual retainer of \$12,500 in the form of the Corporation's common stock. Each of the 8 non-management directors received 637 shares for a total of 5,069 shares. The price per share was \$19.60, the market value on April 28, 2008. The foregoing transaction was made in reliance upon the exemptions from the registration provisions of the Securities Act of 1933, as amended, provided for by Section 4(2) thereof for transactions not involving a public offering.

**ITEM 3. Defaults Upon Senior Securities**

None

**ITEM 4. Submission of Matters to Vote of Security Holders**

The Corporation held its Annual Meeting of Shareholders on April 23, 2008 for the purpose of considering and acting upon a proposal to elect two Class II directors to serve a four year term

The shareholders elected B. Loyall Taylor, Jr. and Andrea F. Gilbert as Class II directors to serve a four year term to expire in 2012 by the following vote:

| Director              | For       | Against/<br>Withheld |
|-----------------------|-----------|----------------------|
| B. Loyall Taylor, Jr. | 7,459,625 | 263,139              |
| Andrea F. Gilbert     | 7,416,478 | 306,285              |



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The following directors continued in office after the Annual Meeting: Thomas L. Bennett, Wendell F. Holland, Scott M. Jenkins, David E. Lees, Francis J. Leto, Britton H. Murdoch and Frederick C. Peters II.

**ITEM 5. Other Information**

None

**ITEM 6. Exhibits**

Exhibits required by Item 601 of Regulation S-K.

The exhibits listed on the Index to Exhibits on Pages 41 and 42 of this report are incorporated by reference or filed or furnished herewith in response to this item.

Signatures

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

Bryn Mawr Bank Corporation

Date: August 6, 2008

By: **/s/ FREDERICK C. PETERS II**  
**Frederick C. Peters II**  
**President & Chief Executive Officer**

Date: August 6, 2008

By: **/s/ J. DUNCAN SMITH**  
**J. Duncan Smith**  
**Treasurer & Chief Financial Officer**

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**Form 10-Q**

**Index to Exhibits**

| <b>Exhibit No.</b> | <b>Description and References</b>  |
|--------------------|--|
| 2.1                | Membership Interest Purchase Agreement, dated as of June 9, 2008, by and among Bryn Mawr Bank Corporation, Marigot Daze LLC, JNJ Holdings LLC, Lau Associates LLC, Lau Professional Services LLC and Judith W. Lau, filed herewith. (The schedules to the Membership Interest Purchase Agreement are listed at the beginning of the agreement but have been omitted from the Exhibit to Form 10-Q. The Registrant agrees to supplementally furnish a copy of any omitted schedule to the Securities and Exchange Commission upon request.) |
| 3.1                | Amended and Restated By-Laws, effective November 20, 2007, incorporated by reference to Exhibit 3.2 of the Corporation's Form 8-K filed with the SEC on November 21, 2007  |
| 3.2                | Amended and Restated Articles of Incorporation, effective November 21, 2007, incorporated by reference to Exhibit 3.1 of the Corporation's Form 8-K filed with the SEC on November 21, 2007  |
| 4.1                | Shareholders Rights Plan, dated November 18, 2003, incorporated by reference to Exhibit 4 of the Corporation's Form 8-A/12G filed with the SEC on November 25, 2003  |
| 4.2                | Amended and Restated By-Laws, effective November 20, 2007, incorporated by reference to Exhibit 3.2 of the Corporation's Form 8-K filed with the SEC on November 21, 2007  |
| 4.3                | Amended and Restated Articles of Incorporation, effective November 21, 2007, incorporated by reference to Exhibit 3.1 of the Corporation's Form 8-K filed with the SEC on November 21, 2007  |
| 4.4                | Subordinated Note Purchase Agreement dated July 30, 2008, a copy of which is not filed herewith in reliance on the provisions of 17 C.F.R. Section 229.601(b)(4)(iii). The registrant agrees to furnish a copy of such agreement to the Commission upon request.   |
| 10.1*              | Amended and Restated Supplemental Employee Retirement Plan of the Bryn Mawr Bank Corporation, effective January 1, 1999, incorporated by reference to Exhibit 10.1 to the Corporation's Form 10-K filed with the SEC on March 13, 2008.  |
| 10.2*              | Executive Change-of-Control Severance Agreement, dated October 19, 1995, between the Bryn Mawr Trust Company and Robert J. Ricciardi, incorporated by reference to Exhibit 10.O of the Corporation's Form 10-K filed with the SEC on March 15, 2007  |
| 10.3**             | The Bryn Mawr Bank Corporation 1998 Stock Option Plan, incorporated by reference to Exhibit B of the Corporation's Proxy Statement dated March 6, 1998 filed with the SEC on March 5, 1998   |
| 10.4*              | Deferred Bonus Plan for Executives of the Bryn Mawr Bank Corporation, dated January 1, 1999, incorporated by reference to Exhibit 10.U of the Corporation's Form 10-K filed with the SEC on March 15, 2007   |
| 10.5*              | Deferred Payment Plan for Directors of the Bryn Mawr Bank Corporation, as amended and restated June 21, 2002, effective January 1, 2000, incorporated by reference to Exhibit 10.5 of the Corporation's Form 10-Q filed with the SEC on May 9, 2008.   |
| 10.6*              | Deferred Payment Plan for Directors of the Bryn Mawr Trust Company, as amended and restated June 21, 2002, effective January 1, 2000, incorporated by reference to Exhibit 10.6 of the Corporation's Form 10-Q filed with the SEC on May 9, 2008.  |
| 10.7*              | Employment Agreement, dated January 11, 2001, between the Bryn Mawr Bank Corporation and Frederick C. Peters II, incorporated by reference to Exhibit 10.N of the Corporation's Form 10-K filed with the SEC on March 29, 2001   |
| 10.8*              | Executive Change-of-Control Severance Agreement, dated January 22, 2001, between the Bryn Mawr Trust Company and Frederick C. Peters II, incorporated by reference to Exhibit 10.K of the Corporation's Form 10-K filed with the SEC on March 15, 2007   |
| 10.9**             | The Bryn Mawr Bank Corporation 2001 Stock Option Plan, incorporated by reference to Appendix B of the Corporation's Proxy Statement dated March 8, 2001 filed with the SEC on March 6, 2001  |
| 10.10**            | Bryn Mawr Bank Corporation 2004 Stock Option Plan, incorporated by reference to Appendix A of the Corporation's Proxy Statement dated March 10, 2004 filed with the SEC on March 8, 2004   |
| 10.11*             |  |

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Executive Change-of-Control Amended and Restated Severance Agreement, dated May 21, 2004, between the Bryn Mawr Trust Company and Alison E. Gers, incorporated by reference to Exhibit 10.M of the Corporation's Form 10-K filed with the SEC on March 15, 2007

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| <b>Exhibit No.</b>  | <b>Description and References</b>  |
|---|--|
| 10.12*  | Executive Change-of-Control Amended and Restated Severance Agreement, dated May 21, 2004, between the Bryn Mawr Trust Company and Joseph G. Keefer, incorporated by reference to Exhibit 10.N of the Corporation's Form 10-K filed with the SEC on March 15, 2007        |
| 10.13*  | Executive Severance and Change of Control Agreement, dated April 4, 2005, between the Bryn Mawr Trust Company and J. Duncan Smith, incorporated by reference to Exhibit 10.1 to the Corporation's Form 8-K filed with the SEC on April 6, 2005                           |
| 10.14**   | Form of Key Employee Non-Qualified Stock Option Agreement, incorporated by reference to Exhibit 10.3 to the Corporation's Form 10-Q filed with the SEC on May 10, 2005   |
| 10.15**   | Form of Non-Qualified Stock Option Agreement for Non-Employee Directors, incorporated by reference to Exhibit 10.2 of the Corporation's Form 10-Q filed with the SEC on May 10, 2005   |
| 10.16*  | Letter Employment Agreement, dated January 3, 2007, from the Bryn Mawr Trust Company to Matthew G. Waschull, incorporated by reference to Exhibit 10.2 of the Corporation's Form 10-Q filed with the SEC on August 7, 2007   |
| 10.17*  | Executive Change-of-Control Amended and Restated Severance Agreement, dated February 5, 2007, between the Bryn Mawr Trust Company and Matthew G. Waschull, incorporated by reference to Exhibit 10.P of the Corporation's Form 10-K filed with the SEC on March 15, 2007 |
| 10.18   | Non-Disclosure and Nonsolicitation Agreement, dated March 9, 2007, between the Bryn Mawr Trust Company and Matthew G. Waschull, incorporated by reference to Exhibit 10.18 to the Corporation's Form 10-K filed with SEC on March 13, 2008.                              |
| 10.19**   | 2007 Long Term Incentive Plan, effective April 25, 2007, incorporated by reference to Exhibit 10.1 of the Corporation's Form 10-Q filed with the SEC May 10, 2007  |
| 31.1  | Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a), filed herewith   |
| 31.2  | Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a), filed herewith.  |
| 32.1  | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith  |
| 32.2  | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith  |
| * Management contract or compensatory plan arrangement.   |  |
| ** Shareholder approved compensatory plan pursuant to which the Registrant's Common Stock may be issued to employees of the Corporation.      |  |
| *** Non-shareholder approved compensatory plan pursuant to which the Registrant's Common Stock may be issued to employees of the Corporation. |  |