

AMERISERV FINANCIAL INC /PA/  
Form 10-Q  
August 07, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 10-Q**

**X**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange  
Act of 1934**

For the period ended June 30, 2009

**Transition Report Pursuant to Section 13 or 15(d) of the Securities  
Exchange Act of 1934**

For the transaction period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-11204

**AmeriServ Financial, Inc.**

(Exact name of registrant as specified in its charter)

Pennsylvania

(State or other jurisdiction of incorporation)

25-1424278

(I.R.S. Employer Identification No.)

or organization)

**Main & Franklin Streets, P.O. Box 430, Johnstown, PA** **15907-0430**

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code **(814) 533-5300**

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

Yes

No

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

Yes

No

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

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

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

Yes

No

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

Class

Outstanding at August 3, 2009

Common Stock, par value \$0.01

21,159,533

per share

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**Item 1. Financial Statements****AmeriServ Financial, Inc.****CONSOLIDATED BALANCE SHEETS**

(In thousands)

(Unaudited)

	<u>June 30, 2009</u>	<u>December 31, 2008</u>
<b>ASSETS</b>		
Cash and due from depository institutions	\$ 17,627	\$ 17,945
Interest bearing deposits	1,713	1,601
Short-term investments in money market funds	<u>7,516</u>	<u>15,578</u>
Total cash and cash equivalents	26,856	35,124
Investment securities:		
Available for sale	122,504	126,781
Held to maturity (market value \$13,967 on June 30, 2009 and \$16,323 on December 31, 2008)	13,615	15,894
Loans held for sale	6,839	1,000
Loans	733,536	706,799
Less: Unearned income	726	691
Allowance for loan losses	<u>13,606</u>	<u>8,910</u>
Net loans	719,204	697,198
Premises and equipment, net	9,034	9,521
Accrued income receivable	4,056	3,735
Goodwill	13,497	13,497
Core deposit intangibles	-	108
Bank owned life insurance	33,433	32,929
Net deferred tax asset	12,496	12,651
Regulatory stock	9,739	9,739
Other assets	<u>7,626</u>	<u>8,752</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 978,899</u></b>	<b><u>\$ 966,929</u></b>

**LIABILITIES**

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Non-interest bearing deposits	\$ 115,289	\$ 116,372
Interest bearing deposits	<u>668,518</u>	<u>578,584</u>
Total deposits	<u>783,807</u>	<u>694,956</u>
Short-term borrowings	43,868	119,920
Advances from Federal Home Loan Bank	13,834	13,858
Guaranteed junior subordinated deferrable interest debentures	<u>13,085</u>	<u>13,085</u>
Total borrowed funds	<u>70,787</u>	<u>146,863</u>
Other liabilities	<u>11,425</u>	<u>11,858</u>
<b>TOTAL LIABILITIES</b>	<u>866,019</u>	<u>853,677</u>

**SHAREHOLDERS' EQUITY**

Preferred stock, no par value; \$1,000 per share liquidation

preference; 2,000,000 shares authorized; there

20,502

20,447

were 21,000 shares issued and outstanding for

the periods presented

Common stock, par value \$0.01 per share; 30,000,000 shares authorized; 26,345,420 shares issued

and 21,156,801 outstanding on June 30,

2009; par value \$2.50 per share; 26,317,450

shares issued and 21,128,831 outstanding on

December 31, 2008

263

65,794

Treasury stock at cost, 5,188,619 shares on June

30, 2009 and December 31, 2008

(68,659)

(68,659)

Capital surplus

144,879

79,353

Retained earnings

19,605

20,533

Accumulated other comprehensive loss, net

(3,710)

(4,216)

**TOTAL SHAREHOLDERS' EQUITY**

112,880

113,252

**TOTAL LIABILITIES AND**

**SHAREHOLDERS' EQUITY**

\$ 978,899

\$ 966,929

See accompanying notes to unaudited consolidated financial statements.





## AmeriServ Financial, Inc.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands)

Unaudited

	Three months ended		Six months ended	
	June 30, <u>2009</u>	June 30, <u>2008</u>	June 30, <u>2009</u>	June 30, <u>2008</u>
<b>INTEREST INCOME</b>				
Interest and fees on loans	\$ 10,544	\$ 9,862	\$ 20,893	\$ 20,324
Interest bearing deposits	1	2	2	8
Short-term investments in money market funds	8	38	22	87
Federal funds sold	-	-	-	4
Investment securities:				
Available for sale	1,337	1,342	2,735	2,865
Held to maturity	<u>165</u>	<u>206</u>	<u>338</u>	<u>444</u>
Total Interest Income	<u>12,055</u>	<u>11,450</u>	<u>23,990</u>	<u>23,732</u>
<b>INTEREST EXPENSE</b>				
Deposits	3,404	3,861	6,659	8,360
Short-term borrowings	71	208	200	840
Advances from Federal Home Loan Bank	129	135	259	271
Guaranteed junior subordinated deferrable interest	-	-	-	-
debentures	<u>280</u>	<u>280</u>	<u>560</u>	<u>560</u>
Total Interest Expense	<u>3,884</u>	<u>4,484</u>	<u>7,678</u>	<u>10,031</u>
<b>NET INTEREST INCOME</b>	8,171	6,966	16,312	13,701
Provision for loan losses	<u>3,300</u>	<u>1,375</u>	<u>5,100</u>	<u>1,525</u>
<b>NET INTEREST INCOME AFTER PROVISION FOR</b>	<u>4,871</u>	<u>5,591</u>	<u>11,212</u>	<u>12,176</u>
<b>LOAN LOSSES</b>				
<b>NON-INTEREST INCOME</b>				
Trust fees	1,438	1,737	2,997	3,527

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Net realized gains (losses) on investment securities	63	(137)	164	(137)
Net gains on loans held for sale	163	121	281	210
Service charges on deposit accounts	710	807	1,383	1,541
Investment advisory fees	152	218	289	444
Bank owned life insurance	254	1,923	504	2,172
Other income	<u>711</u>	<u>674</u>	<u>1,434</u>	<u>1,424</u>
Total Non-Interest Income	<u>3,491</u>	<u>5,343</u>	<u>7,052</u>	<u>9,181</u>

**NON-INTEREST EXPENSE**

Salaries and employee benefits	4,983	4,812	10,075	9,642
Net occupancy expense	641	653	1,363	1,314
Equipment expense	442	414	857	845
Professional fees	873	910	1,793	1,679
Supplies, postage and freight	268	317	562	647
Miscellaneous taxes and insurance	329	344	673	697
FDIC deposit insurance expense	691	20	723	42
FHLB prepayment penalty	-	91	-	91
Amortization of core deposit intangibles	-	216	108	432
Other expense	<u>1,409</u>	<u>1,248</u>	<u>2,644</u>	<u>2,415</u>
Total Non-Interest Expense	<u>9,636</u>	<u>9,025</u>	<u>18,798</u>	<u>17,804</u>

<b>PRETAX INCOME (LOSS)</b>	(1,274)	1,909	(534)	3,553
Income tax expense (benefit)	<u>(335)</u>	<u>393</u>	<u>(128)</u>	<u>808</u>
<b>NET INCOME (LOSS)</b>	(939)	1,516	(406)	2,745

Preferred stock dividends	<u>263</u>	<u>-</u>	<u>522</u>	<u>-</u>
<b>NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS</b>	<u>\$ (1,202)</u>	<u>\$ 1,516</u>	<u>\$ (928)</u>	<u>\$ 2,745</u>

**PER COMMON SHARE DATA:**

Basic:

Net income (loss)	\$ (0.06)	\$ 0.07	\$ (0.04)	\$ 0.13
Average number of shares outstanding	21,151	21,847	21,144	21,954

Diluted:

Net income (loss)	\$ (0.06)	\$ 0.07	\$ (0.04)	\$ 0.13
Average number of shares outstanding	21,152	21,848	21,144	21,955
Cash dividends declared	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00

See accompanying notes to unaudited consolidated financial statements.



## AmeriServ Financial, Inc.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

Unaudited

	Six months ended	Six months ended
	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (406)	\$ 2,745
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Provision for loan loss	5,100	1,525
Depreciation expense	813	740
Amortization expense of core deposit intangibles	108	432
Net amortization of investment securities	61	125
Net realized (gains) loss on investment securities available for sale	(164)	137
Net realized gains on loans held for sale	(281)	(210)
Amortization of deferred loan fees	(257)	(216)
Origination of mortgage loans held for sale	(41,740)	(21,960)
Sales of mortgage loans held for sale	36,182	19,477
Decrease (increase) in accrued income receivable	(321)	235
Decrease in accrued expense payable	(530)	(438)
Earnings on bank owned life insurance	(504)	(515)
Net increase in other assets	(869)	(1,687)
Net increase in other liabilities	<u>509</u>	<u>771</u>
Net cash (used in) provided by operating activities	<u>(2,299)</u>	<u>1,161</u>
<b>INVESTING ACTIVITIES</b>		
Purchases of investment securities - available for sale	(17,241)	(47,362)
Purchases of investment securities - held to maturity	-	(4,464)
Purchases of regulatory stock	-	(3,000)
Proceeds from redemption of regulatory stock	-	4,694
Proceeds from sales of investment securities available for sale	4,746	17,377
Proceeds from maturities of investment securities available for sale	17,580	42,310
Proceeds from maturities of investment securities held to maturity	2,251	5,057
Long-term loans originated	(75,628)	(55,248)
Principal collected on long-term loans	65,436	69,956
Loans purchased or participated	(20,500)	(2,500)
Loans sold or participated	3,950	2,500

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Net decrease (increase) in other short-term loans	174	(46)
Purchases of premises and equipment	(326)	(1,635)
Proceeds from insurance policies	<u>-</u>	<u>2,635</u>
Net cash (used in) provided by investing activities	<u>(19,558)</u>	<u>30,274</u>

**FINANCING ACTIVITIES**

Net increase in deposit accounts	90,549	13,395
Net decrease in other short-term borrowings	(76,052)	(37,878)
Principal borrowings on advances from Federal Home Loan Bank	-	3,000
Principal repayments on advances from Federal Home Loan Bank	(24)	(7,023)
Purchase of treasury stock	-	(1,101)
Guaranteed junior subordinated deferrable interest debenture dividends paid	(508)	(508)
Preferred stock dividends	(426)	-
Proceeds from stock purchase plan	<u>50</u>	<u>50</u>
Net cash provided by (used in) financing activities	<u>13,589</u>	<u>(30,065)</u>

<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	(8,268)	1,370
<b>CASH AND CASH EQUIVALENTS AT JANUARY 1</b>	<u>35,124</u>	<u>24,912</u>
<b>CASH AND CASH EQUIVALENTS AT JUNE 30</b>	<u>\$ 26,856</u>	<u>\$26,282</u>

See accompanying notes to unaudited consolidated financial statements.

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

1.

**Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of AmeriServ Financial, Inc. (the Company) and its wholly-owned subsidiaries, AmeriServ Financial Bank (Bank), AmeriServ Trust and Financial Services Company (Trust Company), and AmeriServ Life Insurance Company (AmeriServ Life). The Bank is a state-chartered full service bank with 18 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at \$1.4 billion that are not recognized on the Company's balance sheet at June 30, 2009. AmeriServ Life is a captive insurance company that engages in underwriting as a reinsurer of credit life and disability insurance.

In addition, the Parent Company is an administrative group that provides support in such areas as audit, finance, investments, loan review, general services, and marketing. Significant intercompany accounts and transactions have been eliminated in preparing the consolidated financial statements.

2.

**Basis of Preparation**

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, all adjustments consisting only of normal recurring entries considered necessary for a fair presentation have been included. They are not, however, necessarily indicative of the results of consolidated operations for a full-year.

On April 28, 2009, the shareholders of the Company voted in favor of amending the Articles of Incorporation to reduce the par value of the common stock from \$2.50 to \$0.01 per share. As a result of the decrease in par value, the balance attributable to the common stock on the balance sheet was reduced with a corresponding increase to capital surplus, resulting in no change in the aggregate amount of shareholders' equity.

For further information, refer to the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

3.

### Accounting Policies

In April 2008, the FASB issued FASB Staff Position No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP 142-3 ). FSP 142-3 amends the factors that should be considered in developing assumptions about renewal or extension used in estimating the useful life of a recognized intangible asset under FAS No. 142, *Goodwill and Other Intangible Assets*. This standard is intended to improve the consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141R and other GAAP. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The measurement provisions of this standard will apply only to intangible assets of the Company acquired after the effective date. The adoption of this standard did not have a material effect on the Company's results of operations or financial position.

In December 2008, the FASB issued FASB Staff Position (FSP) No. FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*. This FSP amends FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, to improve an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. The disclosures about plan assets required by the FSP are to be provided for fiscal years ending after December 15, 2009. The adoption of this FSP is not expected to have a material effect on the Company's results of operations or financial position.

In April 2009, the FASB issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. This FSP relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. FSP No. FAS 157-4 is effective for interim and annual periods ending after June 15, 2009, but entities may early adopt this FSP for the interim and annual periods ending after March 15, 2009. The adoption of this FSP did not have a material effect on the Company's results of operations or financial position.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, which relates to fair value disclosures for any financial instruments that are not currently reflected on the balance sheet of companies at fair value. Prior to issuing this FSP, fair values for these assets and liabilities were only disclosed once a year. The FSP now requires these disclosures on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value. FSP No. FAS 107-1 and APB 28-1 is effective for interim and annual periods ending after June 15, 2009, but entities may early adopt this FSP for the interim and annual periods ending after March 15, 2009. The adoption of this FSP did not have a material effect on the Company's results of operations or financial position as reflected in Note 8.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities. FSP No. FAS 115-2 and FAS 124-2 are

effective for interim and annual periods ending after June 15, 2009, but entities may early adopt this FSP for the interim and annual periods ending after March 15, 2009. The adoption of this FSP did not have a material effect on the Company's results of operations or financial position.

In June 2009, the FASB issued FAS No. 167, *Amendments to FASB Interpretation No. 46(R)*. FAS 167, which amends FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, (FIN 46(R)), prescribes a qualitative model for identifying whether a company has a controlling financial interest in a variable interest entity (VIE) and eliminates the quantitative model prescribed by FIN 46(R). The new model identifies two primary characteristics of a controlling financial interest: (1) provides a company with the power to direct significant activities of the VIE, and (2) obligates a company to absorb losses of and/or provides rights to receive benefits from the VIE. FAS No. 167 requires a company to reassess on an ongoing basis whether it holds a controlling financial interest in a VIE. A company that holds a controlling financial interest is deemed to be the primary beneficiary of the VIE and is required to consolidate the VIE. This statement is effective for fiscal years beginning after November 15, 2009. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In June 2009, the FASB issued FAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. FAS No. 168 establishes the *FASB Accounting Standards Codification* (Codification), which was officially launched on July 1, 2009, and became the primary source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under the authority of Federal securities laws are also sources of authoritative GAAP for SEC registrants. The subsequent issuances of new standards will be in the form of Accounting Standards Updates that will be included in the Codification. FAS No. 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. As such, the Company plans to adopt FAS No. 168 in connection with its third quarter 2009 reporting. As the Codification is neither expected nor intended to change GAAP, the adoption of FAS No. 168 will not have a material impact on its results of operations or financial position.

4.

#### **Earnings Per Common Share**

Basic earnings per share include only the weighted average common shares outstanding. Diluted earnings per share include the weighted average common shares outstanding and any potentially dilutive common stock equivalent shares in the calculation. Treasury shares are treated as retired for earnings per share purposes. Options and warrants to purchase 1,544,509 common shares, at exercise prices ranging from \$2.31 to \$6.10, and 220,909 common shares, at exercise prices ranging from \$3.01 to \$6.10, were outstanding as of June 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per common share because to do so would be antidilutive. Dividends on preferred shares are deducted from net income in the calculation of earnings per common share.

Three months ended

Six months ended



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	June 30,		June 30,	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	(In thousands, except per share data)			
<b>Numerator:</b>				
Net income (loss)	\$ (939)	\$ 1,516	\$ (406)	\$ 2,745
Preferred stock dividends	<u>263</u>	<u>-</u>	<u>522</u>	<u>-</u>
Net Income (loss) available to common shareholders	<u>\$ (1,202)</u>	<u>\$ 1,516</u>	<u>\$ (928)</u>	<u>\$ 2,745</u>
<b>Denominator:</b>				
Weighted average common shares				
outstanding (basic)	21,151	21,847	21,144	21,954
Effect of stock options/warrants	<u>1</u>	<u>1</u>	<u>-</u>	<u>1</u>
Weighted average common shares outstanding (diluted)	<u>21,152</u>	<u>21,848</u>	<u>21,144</u>	<u>21,955</u>
<b>Earnings (loss) per common share:</b>				
Basic	\$(0.06)	\$0.07	\$(0.04)	\$0.13
Diluted	(0.06)	0.07	(0.04)	0.13

5.

**Comprehensive Income (Loss)**

For the Company, comprehensive income includes net income and unrealized holding gains and losses from available for sale investment securities and the pension obligation change for the defined benefit plan. The changes in other comprehensive income are reported net of income taxes, as follows (in thousands):

	Three months ended		Six months ended	
	June 30,		June 30,	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Net income (loss)	<u>\$ (939)</u>	<u>\$ 1,516</u>	<u>\$ (406)</u>	<u>\$ 2,745</u>
Other comprehensive income (loss), before tax:				
Pension obligation change for defined benefit plan	118	82	236	165
Income tax effect	(40)	(28)	(80)	(57)
Reclassification adjustment for (gains) losses on				
available for sale securities included in net				
income (loss)	(63)	137	(164)	137
Income tax effect	21	(47)	56	(47)
Unrealized holding (gains) losses on				
available for sale				
securities arising during period	(347)	(1,508)	694	93
Income tax effect	<u>118</u>	<u>513</u>	<u>(236)</u>	<u>(31)</u>
Other comprehensive income (loss)	<u>(193)</u>	<u>(851)</u>	<u>506</u>	<u>260</u>
Comprehensive income (loss)	<u>\$ (1,132)</u>	<u>\$ 665</u>	<u>\$ 100</u>	<u>\$ 3,005</u>

6.

### Consolidated Statement of Cash Flows

On a consolidated basis, cash and cash equivalents include cash and due from depository institutions, interest-bearing deposits, federal funds sold and short-term investments in money market funds. The Company made \$111,000 in income tax payments in the first six months of 2009 as compared to \$184,000 for the first six months of 2008. The Company made total interest payments of \$8,208,000 in the first six months of 2009 compared to \$10,469,000 in the same 2008 period.

7.

### Investment Securities

The cost basis and fair values of investment securities are summarized as follows (in thousands):

**Investment securities available for sale (AFS):**

June 30, 2009	Cost <u>Basis</u>	Gross Unrealized <u>Gains</u>	Gross Unrealized <u>Losses</u>	Fair <u>Value</u>
U.S. Agency	\$ 10,802	\$ 75	\$ -	\$ 10,877
U.S. Agency mortgage- backed securities	109,011	2,672	(69)	111,614
Other securities	<u>25</u>	<u>-</u>	<u>(12)</u>	<u>13</u>
Total	<u>\$119,838</u>	<u>\$ 2,747</u>	<u>\$ (81)</u>	<u>\$ 122,504</u>

**Investment securities held to maturity (HTM):**

June 30, 2009	Cost <u>Basis</u>	Gross Unrealized <u>Gains</u>	Gross Unrealized <u>Losses</u>	Fair <u>Value</u>
U.S. Treasury	\$ 3,046	\$ 67	\$ -	\$ 3,113
U.S. Agency mortgage- backed securities	8,569	294	-	8,863
Other securities	<u>2,000</u>	<u>-</u>	<u>(9)</u>	<u>1,991</u>
Total	<u>\$ 13,615</u>	<u>\$ 361</u>	<u>\$ (9)</u>	<u>\$ 13,967</u>

**Investment securities available for sale (AFS):**

December 31, 2008	Cost <u>Basis</u>	Gross Unrealized <u>Gains</u>	Gross Unrealized <u>Losses</u>	Fair <u>Value</u>
U.S. Agency	\$ 10,387	\$ 188	\$ -	\$ 10,575
U.S. Agency mortgage-backed securities	114,380	2,057	(248)	116,189
Other securities	<u>24</u>	<u>-</u>	<u>(7)</u>	<u>17</u>
Total	<u>\$124,791</u>	<u>\$ 2,245</u>	<u>\$ (255)</u>	<u>\$126,781</u>

**Investment securities held to maturity (HTM):**

December 31, 2008	Cost	Gross	Gross	Fair
		Unrealized	Unrealized	Value
	<u>Basis</u>	<u>Gains</u>	<u>Losses</u>	
U.S. Treasury	\$ 3,082	\$ 118	\$ -	\$ 3,200
U.S. Agency mortgage-backed securities	9,562	321	-	9,883
Other securities	<u>3,250</u>	<u>-</u>	<u>(10)</u>	<u>3,240</u>
Total	<u>\$ 15,894</u>	<u>\$ 439</u>	<u>\$ (10)</u>	<u>\$ 16,323</u>

Maintaining investment quality is a primary objective of the Company's investment policy which, subject to certain limited exceptions, prohibits the purchase of any investment security below a Moody's Investor's Service or Standard & Poor's rating of "A." At June 30, 2009 and December 31, 2008, 98.5% and 97.7% of the portfolio was rated "AAA", respectively. Less than 1% of the portfolio was rated below A or unrated at June 30, 2009 and December 31, 2008. At June 30, 2009, the Company's consolidated investment securities portfolio had a modified duration of approximately 2.4 years. The gross gains on investment security sales in the first six months of 2009 were \$164,000. The Company has no exposure to sub-prime mortgage loans in either the loan or investment portfolios.

The following tables present information concerning investments with unrealized losses as of June 30, 2009 and December 31, 2008 (in thousands):

**Investment securities available for sale:**

June 30, 2009	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>
U.S. Agency mortgage-backed securities	\$ 6,910	\$ (59)	\$ 4,449	\$ (10)	\$ 11,359	\$ (69)
Other securities	<u>-</u>	<u>-</u>	<u>13</u>	<u>(12)</u>	<u>13</u>	<u>(12)</u>
Total	<u>\$ 6,910</u>	<u>\$ (59)</u>	<u>\$ 4,462</u>	<u>\$ (22)</u>	<u>\$ 11,372</u>	<u>\$ (81)</u>

**Investment securities held to maturity:**

June 30, 2009	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>
Other securities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,991</u>	<u>\$ (9)</u>	<u>\$ 1,991</u>	<u>\$ (9)</u>
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,991</u>	<u>\$ (9)</u>	<u>\$ 1,991</u>	<u>\$ (9)</u>

**Investment securities available for sale:**

December 31, 2008	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>
U.S. Agency mortgage-backed securities	\$ 31,063	\$ (226)	\$ 3,375	\$ (22)	\$ 34,438	\$ (248)
Other securities	<u>-</u>	<u>-</u>	<u>17</u>	<u>(7)</u>	<u>17</u>	<u>(7)</u>
Total	<u>\$ 31,063</u>	<u>\$ (226)</u>	<u>\$ 3,392</u>	<u>\$ (29)</u>	<u>\$ 34,455</u>	<u>\$ (255)</u>

**Investment securities held to maturity:**

December 31, 2008	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>
Other securities	\$ -	\$ -	\$ 3,240	\$ (10)	\$ 3,240	\$ (10)
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,240</u>	<u>\$ (10)</u>	<u>\$ 3,240</u>	<u>\$ (10)</u>

The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. There are nine positions that are considered temporarily impaired at June 30, 2009. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Management has also concluded that based on current information they expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, management does not intend to sell these securities and does not believe it will be required to sell these securities before they recover in value.

8.

**Disclosures About Fair Value Measurements**

Effective January 1, 2008, the Company adopted the provisions of FAS No. 157, *Fair Value Measurements*, for financial assets and financial liabilities. FAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. The FASB issued Staff Position No. 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*, which removed leasing transactions accounted for under FAS No. 13 and related guidance from the scope of FAS No. 157. The FASB also issued Staff Position No. 157-2, *Partial Deferral of the Effective Date of Statement 157*, which deferred the effective date of FAS No. 157 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008.

FAS No. 157 establishes a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by FAS No. 157 hierarchy are as follows:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.

Level III: Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. This applies to all available for sale securities except U.S. Treasury and equity securities which are considered to be Level 1.

Residential real estate loans held for sale are carried at fair value on a recurring basis. Residential real estate loans are valued based on quoted market prices from purchase commitments from market participants and are classified as Level 1.

The fair value of the swap asset is based on an external derivative valuation model using data inputs as of the valuation date and classified Level 2.

The following tables present the assets reported on the balance sheet at their fair value as of June 30, 2009 and December 31, 2008, by level within the fair value hierarchy. As required by FAS No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

#### Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below (in thousands):

	<u>Fair Value Measurements at June 30, 2009 Using</u>			
	<u>Quoted Prices in</u>	<u>Significant Other</u>	<u>Significant</u>	
	<u>Active Markets for</u>	<u>Observable</u>	<u>Unobservable</u>	
	<u>Identical Assets</u>	<u>Inputs</u>	<u>Inputs</u>	
		<u>(Level 2)</u>	<u>(Level 3)</u>	
	<u>Total</u>	<u>(Level 1)</u>		
Assets:				
Available for sale securities	\$122,504	\$ 13	\$ 122,491	\$ -
Loans held for sale	6,839	6,839	-	-
Fair value of swap asset	69	-	69	-

	<u>Fair Value Measurements at December 31, 2008 Using</u>			
	<u>Quoted Prices in</u>	<u>Significant Other</u>	<u>Significant</u>	
	<u>Active Markets for</u>	<u>Observable</u>	<u>Unobservable</u>	
	<u>Identical Assets</u>	<u>Inputs</u>	<u>Inputs</u>	
		<u>(Level 2)</u>	<u>(Level 3)</u>	
	<u>Total</u>	<u>(Level 1)</u>		
Assets:				
Available for sale securities	\$126,781	\$ 17	\$ 126,764	\$ -
Loans held for sale	1,000	1,000	-	-
Fair value of swap asset	336	-	336	-

Loans considered impaired under FAS 114, *Accounting by Creditors for Impairment of a Loan*, as amended by FAS 118, *Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosure*, are loans for which, based on current information and events, it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are reported at fair value of the underlying collateral if the repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 input based on the discounting of the collateral. At June 30, 2009, impaired loans with a carrying value of \$10.2 million were reduced by specific valuation allowance totaling \$3.9 million resulting in a net fair value of \$6.3 million, based on Level 3 inputs.

Other real estate owned (OREO) is measured at fair value, based on appraisals less cost to sell at the date of foreclosure. Valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less cost to sell. Income and expenses from operations and changes in valuation allowance are included in the net expenses from OREO.

Assets Measured on a Non-recurring Basis

Assets measured at fair value on a non-recurring basis are summarized below (in thousands):

	<u>Fair Value Measurements at June 30, 2009 Using</u>			
	<u>Total</u>	Quoted Prices in	Significant Other	Significant
		Active Markets for	Observable	Unobservable
		Identical Assets	Inputs	Inputs
	(Level 1)	(Level 2)	(Level 3)	
Assets:				
Impaired loans	\$ 6,301	\$ -	\$ -	\$ 6,301
Other real estate owned	1,067	-	1,067	-

	<u>Fair Value Measurements at December 31, 2008 Using</u>			
	<u>Total</u>	Quoted Prices in	Significant Other	Significant
		Active Markets for	Observable	Unobservable
		Identical Assets	Inputs	Inputs
	(Level 1)	(Level 2)	(Level 3)	
Assets:				
Impaired loans	\$ 857	\$ -	\$ 857	\$ -
Other real estate owned	1,195	-	1,195	-

DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS



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For the Company, as for most financial institutions, approximately 90% of its assets and liabilities are considered financial instruments. Many of the Company's financial instruments, however, lack an available trading market characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimates and present value calculations were used by the Company for the purpose of this disclosure.

Estimated fair values have been determined by the Company using independent third party valuations that uses best available data (Level 2) and an estimation methodology (level 3) the Company believes is suitable for each category of financial instruments. Management believes that cash, cash equivalents, and loans and deposits with floating interest rates have estimated fair values which approximate the recorded book balances. The estimation methodologies used, the estimated fair values based off of FAS 157 measurements, and recorded book balances at June 30, 2009 and December 31, 2008, were as follows:

	<u>June 30, 2009</u>		<u>December 31, 2008</u>	
	ESTIMATED	RECORDED	ESTIMATED	RECORDED
	<u>FAIR VALUE</u>	<u>BOOK</u>	<u>FAIR VALUE</u>	<u>BOOK</u>
		<u>BALANCE</u>		<u>BALANCE</u>
		(IN THOUSANDS)		
<b>FINANCIAL ASSETS:</b>				
Investment securities	\$ 136,471	\$ 136,119	\$ 143,104	\$ 142,675
Regulatory stock	9,739	9,739	9,739	9,739
Net loans (including loans held for sale), net of allowance for loan loss	724,084	726,043	701,066	698,198
Accrued income receivable	4,056	4,056	3,735	3,735
Bank owned life insurance	33,433	33,433	32,929	32,929
Fair value swap asset	69	69	336	336
<b>FINANCIAL LIABILITIES:</b>				
Deposits with no stated maturities	\$ 432,045	\$ 432,045	\$ 377,646	\$ 377,646
Deposits with stated maturities	354,235	351,762	320,201	317,310
Short-term borrowings	43,868	43,868	119,920	119,920
All other borrowings	29,884	26,919	31,472	26,943
Accrued interest payable	3,532	3,532	4,062	4,062
Fair value swap liability	69	69	336	336

The fair value of investment securities is equal to the available quoted market price.

The fair value of regulatory stock is equal to the current carrying value.

The net loan portfolio has been valued using a present value discounted cash flow. The discount rate used in these calculations is based upon the treasury yield curve adjusted for non-interest operating costs, credit loss, current market prices and assumed prepayment risk.

The fair value of accrued income receivable is equal to the current carrying value.

The fair value of bank owned life insurance is based upon the cash surrender value of the underlying policies and matches the book value.

Deposits with stated maturities have been valued using a present value discounted cash flow with a discount rate approximating current market for similar assets and liabilities. Deposits with no stated maturities have an estimated fair value equal to both the amount payable on demand and the recorded book balance.

The fair value of short-term borrowings is equal to the current carrying value.

The fair value of other borrowed funds are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities.

The fair value of accrued interest payable is equal to the current carrying value.

The fair values of the fair value swaps used for interest rate risk management represents the amount the Company would have expected to receive or pay to terminate such agreements.

Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values. The Company's remaining assets and liabilities which are not considered financial instruments have not been valued differently than has been customary under historical cost accounting.

**Loans**

The loan portfolio of the Company consists of the following (in thousands):

	June 30,	December 31,
	<u>2009</u>	<u>2008</u>
Commercial	\$ 118,378	\$ 110,197
Commercial loans secured by real estate	381,986	353,870
Real estate mortgage	208,154	218,928
Consumer	<u>25,018</u>	<u>23,804</u>
Total loans	733,536	706,799
Less: Unearned income	<u>726</u>	<u>691</u>
Loans, net of unearned income	<u>\$ 732,810</u>	<u>\$ 706,108</u>

Real estate-construction loans comprised 6.8%, and 6.2% of total loans, net of unearned income, at June 30, 2009 and December 31, 2008, respectively. The Company has no exposure to sub prime mortgage loans in either the loan or investment portfolios.

10.

**Allowance for Loan Losses**

An analysis of the changes in the allowance for loan losses follows (in thousands, except ratios):

	Three months ended		Six months ended	
	June 30,		June 30,	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Balance at beginning of period	\$ 10,661	\$ 7,309	\$ 8,910	\$ 7,252
Charge-offs:				
Commercial	(638)	(100)	(641)	(106)
Commercial loans secured by real estate	(200)	(791)	(237)	(791)
Real estate-mortgage	(41)	(83)	(67)	(121)
Consumer	<u>(69)</u>	<u>(95)</u>	<u>(120)</u>	<u>(182)</u>
Total charge-offs	<u>(948)</u>	<u>(1,069)</u>	<u>(1,065)</u>	<u>(1,200)</u>
Recoveries:				

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Commercial	567	289	569	294
Commercial loans secured by real estate	-	23	5	29
Real estate-mortgage	4	20	22	21
Consumer	<u>22</u>	<u>16</u>	<u>65</u>	<u>42</u>
Total recoveries	<u>593</u>	<u>348</u>	<u>661</u>	<u>386</u>
Net charge-offs	(355)	(721)	(404)	(814)
Provision for loan losses	<u>3,300</u>	<u>1,375</u>	<u>5,100</u>	<u>1,525</u>
Balance at end of period	<u>\$ 13,606</u>	<u>\$ 7,963</u>	<u>\$ 13,606</u>	<u>\$ 7,963</u>

As a percent of average loans and loans held

for sale, net of unearned income:				
Annualized net charge-offs	0.19%	0.46%	0.11%	0.26%
Annualized provision for loan losses	1.81	0.89	1.42	0.49
Allowance as a percent of loans and loans held for sale, net of unearned income				
at period end	1.84	1.28	1.84	1.28

11.

**Non-performing Assets**

The following table presents information concerning non-performing assets (in thousands, except percentages):

	June 30, <u>2009</u>	December 31, <u>2008</u>
<u>Non-accrual loans</u>		
Commercial	\$ 7,317	\$ 1,128
Commercial loans secured by real estate	2,886	484
Real estate-mortgage	1,009	1,313
Consumer	<u>620</u>	<u>452</u>
Total	<u>11,832</u>	<u>3,377</u>

90 days past due

Commercial	<u>1,771</u>	<u>-</u>
Total	<u>1,771</u>	<u>-</u>

Other real estate owned

Commercial loans secured by real estate	700	701
Real estate-mortgage	<u>367</u>	<u>494</u>
Total	<u>1,067</u>	<u>1,195</u>

Total non-performing assets	<u>\$14,670</u>	<u>\$ 4,572</u>
Total non-performing assets as a percent of loans and loans held for sale, net of unearned income,  and other real estate owned	1.98%	0.65%

The following table sets forth, for the periods indicated, (i) the gross interest income that would have been recorded if non-accrual loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination if held for part of the period, (ii) the amount of interest income actually recorded on such loans, and (iii) the net (increase) reduction in interest income attributable to such loans (in thousands).

	Three months ended		Six months ended	
	June 30,		June 30,	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Interest income due in accordance with original terms	\$ 61	\$ 44	\$ 110	\$ 97
Interest income recorded	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net reduction in interest income	<u>\$ 61</u>	<u>\$ 44</u>	<u>\$ 110</u>	<u>\$ 97</u>

12.

**Federal Home Loan Bank Borrowings**

Total Federal Home Loan Bank (FHLB) borrowings and advances consist of the following at June 30, 2009, (in thousands, except percentages):

Weighted

<u>Type</u>	<u>Maturing</u>	<u>Amount</u>	<u>Average Rate</u>
Open Repo Plus	Overnight	\$ 18,868	0.67%
Advances	2009	28,004	0.87
	2010	10,000	3.36
	2011 and after	<u>830</u>	6.44
		<u>38,834</u>	1.63
Total FHLB borrowings		<u>\$ 57,702</u>	1.31%

The rate on Open Repo Plus advances can change daily, while the rate on the advances is fixed until the maturity of the advance.

13.

### **Preferred Stock**

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (initially introduced as the Troubled Asset Relief Program or TARP ) was enacted. On October 14, 2008, the U.S. Treasury announced its intention to inject capital into financial institutions under the TARP Capital Purchase Program (the CPP ). The CPP is a voluntary program designed to provide capital to healthy, well managed financial institutions in order to increase the availability of credit to businesses and individuals and help stabilize the U.S. financial system.

On December 19, 2008, the Company sold to the U.S. Treasury for an aggregate purchase price of \$21 million in cash 21,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series D. In conjunction with the purchase of these senior preferred shares, the U.S. Treasury also received warrants to purchase up to 1,312,500 shares of the Company's common stock. The warrants have a term of 10 years and are exercisable at any time, in whole or in part, at an exercise price of \$2.40 per share. The \$21 million in proceeds was allocated to the Series D Preferred Stock and the warrants based on their relative fair values at issuance (approximately \$20.4 million was allocated to the Series D Preferred Stock and approximately \$600,000 to the warrants). The difference between the initial value allocated to the Series D Preferred Stock of approximately \$20.4 million and the liquidation value of \$21 million will be charged to surplus over the first three years of the contract. Cumulative dividends on Series D Preferred Stock are payable quarterly at 5% through December 19, 2013 and at a rate of 9% thereafter. As a result of the decision by the Company to accept a preferred stock investment under the U.S. Treasury's CPP for a period of three years the Company is no longer permitted to repurchase stock or declare and pay dividends on common stock without the consent of the U.S. Treasury.

14.

### **Regulatory Capital**

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

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. As of June 30, 2009, the Federal Reserve categorized the Company as Well Capitalized under the regulatory framework for prompt corrective action. The Company believes that no conditions or events have occurred that would change this conclusion. To be categorized as well capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. Additionally, while not a regulatory capital ratio, the Company's tangible common equity ratio was 8.17% at June 30, 2009.

<u>June 30, 2009</u>	<u>Amount</u>	Actual		Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
		<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	
(In thousands, except ratios)							
Total Capital (to Risk							
W e i g h t e d Assets)							
Consolidated	\$120,814	15.56%	\$ 62,106	8.00%	\$ 77,632	10.00%	
Bank	94,476	12.37	61,116	8.00	76,395	10.00	
Tier 1 Capital (to Risk							
W e i g h t e d Assets)							
Consolidated	111,056	14.31	31,053	4.00	46,579	6.00	
Bank	84,870	11.11	30,558	4.00	45,837	6.00	
Tier 1 Capital (to Average Assets)							

Consolidated	111,056	11.61	38,251	4.00	47,814	5.00
Bank	84,870	9.15	37,106	4.00	46,382	5.00

15.

### Segment Results

The financial performance of the Company is also monitored by an internal funds transfer pricing profitability measurement system which produces line of business results and key performance measures. The Company's major business units include retail banking, commercial lending, trust, and investment/parent. The reported results reflect the underlying economics of the business segments. Expenses for centrally provided services are allocated based upon the cost and estimated usage of those services. The businesses are match-funded and interest rate risk is centrally managed and accounted for within the investment/parent business segment. The key performance measure the Company focuses on for each business segment is net income contribution.

Retail banking includes the deposit-gathering branch franchise, lending to both individuals and small businesses, and financial services. Lending activities include residential mortgage loans, direct consumer loans, and small business commercial loans. Financial services include the sale of mutual funds, annuities, and insurance products. Commercial lending to businesses includes commercial loans, and commercial real-estate loans. The trust segment has two primary business divisions, traditional trust and union collective investment funds. Traditional trust includes personal trust products and services such as personal portfolio investment management, estate planning and administration, custodial services and pre-need trusts. Also, institutional trust products and services such as 401(k) plans, defined benefit and defined contribution employee benefit plans, and individual retirement accounts are included in this segment. The union collective investment funds, namely the ERECT and BUILD Funds are designed to invest union pension dollars in construction projects that utilize union labor. The financial results of West Chester Capital Advisors, a registered investment advisory firm, are also included in the Trust segment. The investment/parent includes the net results of investment securities and borrowing activities, general corporate expenses not allocated to the business segments, interest expense on the guaranteed junior subordinated deferrable interest debentures, and centralized interest rate risk management. Inter-segment revenues were not material.

The contribution of the major business segments to the consolidated results of operations for the three and six months ended June 30, 2009 and 2008 were as follows (in thousands):

	Three months ended		Six months ended		<u>June 30, 2009</u>
	<u>June 30, 2009</u>	<u>June 30, 2009</u>	<u>June 30, 2009</u>	<u>June 30, 2009</u>	
	<u>Total revenue</u>	<u>Net income</u> <u>(loss)</u>	<u>Total revenue</u>	<u>Net income</u> <u>(loss)</u>	<u>Total assets</u>
Retail banking	\$ 6,316	\$ 96	\$ 12,329	\$ 473	\$ 329,005
Commercial lending	3,063	(1,319)	6,060	(1,620)	510,270
Trust	1,607	104	3,319	248	3,505



Investment/Parent	<u>676</u>	<u>180</u>	<u>1,656</u>	<u>493</u>	<u>136,119</u>
Total	<u>\$ 11,662</u>	<u>\$ (939)</u>	<u>\$ 23,364</u>	<u>\$ (406)</u>	<u>\$ 978,899</u>

	Three months ended		Six months ended		<u>June 30, 2008</u>
	<u>June 30, 2008</u>		<u>June 30, 2008</u>		
	<u>Total revenue</u>	<u>Net income</u> <u>(loss)</u>	<u>Total revenue</u>	<u>Net income</u> <u>(loss)</u>	<u>Total assets</u>
Retail banking	\$ 7,320	\$ 1,346	\$ 13,128	\$ 1,726	\$ 332,466
Commercial lending	2,800	188	5,418	918	392,781
Trust	1,972	352	4,013	815	3,164
Investment/Parent	<u>217</u>	<u>(370)</u>	<u>323</u>	<u>(714)</u>	<u>148,819</u>
Total	<u>\$ 12,309</u>	<u>\$ 1,516</u>	<u>\$ 22,882</u>	<u>\$ 2,745</u>	<u>\$ 877,230</u>

16.

### Commitments and Contingent Liabilities

The Company's exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Bank uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending. The Company had various outstanding commitments to extend credit approximating \$124.5 million and standby letters of credit of \$12.7 million as of June 30, 2009.

Additionally, the Company is also subject to a number of asserted and unasserted potential claims encountered in the normal course of business. In the opinion of the Company, neither the resolution of these claims nor the funding of these credit commitments will have a material adverse effect on the Company's consolidated financial position, results of operation or cash flows.

17.

### Pension Benefits

The Company has a noncontributory defined benefit pension plan covering all employees who work at least 1,000 hours per year. The benefits of the plan are based upon the employee's years of service and average annual earnings for the highest five consecutive calendar years during the final ten year period of employment. Plan assets are primarily debt securities (including U.S. Treasury and Agency securities, corporate notes and bonds), listed common stocks (including shares of AmeriServ Financial, Inc. common stock which is limited to 10% of the plan's assets), mutual funds, and short-term cash equivalent instruments.

	Three months ended		Six months ended	
	June 30,		June 30,	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Components of net periodic benefit cost				
Service cost	\$ 232	\$ 241	\$ 464	\$ 482
Interest cost	234	233	468	465
Expected return on plan assets	(308)	(309)	(616)	(619)
Amortization of prior year service cost	3	1	6	2
Amortization of transition asset	(4)	(4)	(8)	(8)
Recognized net actuarial loss	<u>119</u>	<u>85</u>	<u>238</u>	<u>171</u>
Net periodic pension cost	<u>\$ 276</u>	<u>\$ 247</u>	<u>\$ 552</u>	<u>\$ 493</u>

18.

**Subsequent Events**

On June 30, 2009, the Company adopted *Statement of Financial Accounting Standards No. 165, Subsequent Events (SFAS 165)*. The Statement establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, the Statement defines: (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (3) the disclosure that an entity should make about events or transactions that occurred after the balance sheet date. Management has reviewed events occurring through August 7, 2009, the date the financial statements were issued and no subsequent events occurred requiring accrual or disclosure.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ("M.D. & A.")**

**2009 SECOND QUARTER SUMMARY OVERVIEW** .. One of the most important axioms that undergirds AmeriServ's reinvention is a resolve to always be coldly realistic about the affairs of this Company. It is no secret that the U.S. economy is experiencing serious difficulties. In such times it is even more important to view every metric carefully. We learned some time ago that it is the length of a recession, more than the depth of a recession, which is most troubling to a community bank. Most community bank borrowers are relatively small and medium sized businesses with limited resources. They rely almost exclusively on their bank for credit. However, as a recession lengthens, these companies experience intense stress that may overcome their limited resources. With the recession continuing, the stress is mounting and its impact is clearly visible in the second quarter 2009 AmeriServ financial results.

AmeriServ Financial reported a net loss of \$939,000 or \$0.06 per share for the second quarter, and a cumulative net loss of \$406,000 or \$0.04 per share for the first half of 2009. This loss was brought about by the weakening of some specific borrowing relationships. In one case, AmeriServ has already begun to take possession of the borrower's assets and is instituting the necessary actions to liquidate those remaining assets. In two other cases, AmeriServ continues to work with the principals to plot the best course of action. The source of these troubled loan difficulties is the recession. True to our resolve, AmeriServ has taken action to increase the allowance for loan losses, while taking immediate action with the borrowers. The increase in the allowance brought about the net loss for the quarter. The allowance for loan losses was increased by \$2,945,000 over March 31, 2009, and is sufficient to provide 100% coverage of all non-performing loans.

Just as in the difficult days of 2003 and 2004 AmeriServ will always take the necessary and swift action to address troubled assets. Such a dramatic increase in the allowance for loan loss does not mean major future losses are inevitable. Thus far in 2009 we are encouraged to note that in spite of the sharp increase in non-performing loans, the level of actual net charge-offs in 2009 is still below peer averages at \$404,000 or 0.11% of total loans. But we know that troubled loans do not correct themselves, and therefore, we are hard at work on every one.

We should also note that, on a day-to-day basis, AmeriServ continues to generate positive momentum within its retail banking operation. In the second quarter

Loans outstanding increased by more than \$12 million.

Deposits surged to a new high, increasing by more than \$36 million.

Non-interest income remained stable in spite of a decline in Trust Company fees due to the lower levels of the equity and real estate markets.

Borrowings from the Federal Home Loan Bank declined by \$33 million.

Mortgage originations during the first half of 2009 increased by 65% (\$18 million) over the same period in 2008, emphasizing this important community bank product.

Capital ratios continued to be strong with the asset leverage ratio at 11.61% and tangible common equity at 8.17%. Both ratios are well above industry averages.

While expenses increased by \$474,000 from the first quarter, this increase was almost entirely the result of a Federal Deposit Insurance Corporation special assessment levied on every bank to strengthen the nation's deposit insurance fund.

AmeriServ remains a participant in the U.S. Treasury Capital Purchase Program. We have endeavored, through our continuing loan growth, to observe and perform in the spirit of the nation's recovery program. There is no way to project when this difficult and lengthy recession will end. That is why it is so important to monitor every loan and, when necessary, to take the kind of preventative action that characterizes the second quarter for AmeriServ. The Board and the management team pledge a continuing high level of vigilance. It is our goal that this vigilance, the conservative balance sheet of AmeriServ and our policy of speedy corrective actions will help protect this franchise from the serious difficulties in the banking industry. We further believe that adhering to this vigilance will position AmeriServ to prosper when these difficult days give way to a true economic recovery.

**THREE MONTHS ENDED JUNE 30, 2009 VS. THREE MONTHS ENDED JUNE 30, 2008**

.....**PERFORMANCE OVERVIEW**.....The following table summarizes some of the Company's key performance indicators (in thousands, except per share and ratios).

	Three months ended <u>June 30, 2009</u>	Three months ended <u>June 30, 2008</u>
Net income (loss)	\$ (939)	\$ 1,516
Diluted earnings (loss) per share	(0.06)	0.07
Return on average assets (annualized)	(0.39)%	0.71%

Return on average equity (annualized) (3.29)% 6.64%

The Company reported a net loss of \$939,000 or \$0.06 loss per diluted common share for the second quarter of 2009. This represents a decrease of \$2.5 million from the second quarter 2008 net income of \$1.5 million or \$0.07 per diluted common share. Diluted earnings per share declined by a greater extent than net income due to the preferred dividend requirement on the CPP preferred stock in 2009, which amounted to \$263,000 and reduced the amount of net income available to common shareholders. An increased provision for loan losses and higher FDIC insurance expense were the primary factors causing the decline in earnings between periods. We prudently increased our allowance for loan losses to respond to higher non-performing loans as the continued recessionary economic environment is negatively impacting our commercial borrowers. This higher provision for loan losses more than offset increased net interest income that resulted from strong loan and deposit growth within our retail bank.

.....**NET INTEREST INCOME AND MARGIN**.....The Company's net interest income represents the amount by which interest income on average earning assets exceeds interest paid on average interest bearing liabilities. Net interest income is a primary source of the Company's earnings, it is

affected by interest rate fluctuations as well as changes in the amount and mix of average earning assets and average interest bearing liabilities. The following table compares the Company's net interest income performance for the second quarter of 2009 to the second quarter of 2008 (in thousands, except percentages):

	Three months ended	Three months ended		
	<u>June 30, 2009</u>	<u>June 30, 2008</u>	<u>Change</u>	<u>% Change</u>
Interest income	\$ 12,055	\$ 11,450	\$ 605	5.3%
Interest expense	<u>3,884</u>	<u>4,484</u>	<u>(600)</u>	(13.4)
Net interest income	<u>\$ 8,171</u>	<u>\$ 6,966</u>	<u>\$ 1,205</u>	17.3
Net interest margin	3.66%	3.58%	0.08	N/M
N/M - not meaningful				

The Company's net interest income in the second quarter of 2009 increased by \$1.2 million or 17.3% from the prior year's second quarter and the net interest margin rose by eight basis points to 3.66% over the same comparative period. The increased net interest income and margin resulted from a combination of good balance sheet growth and the pricing benefits achieved from a steeper positively sloped yield curve. Specifically, total loans averaged \$733 million in the second quarter of 2009, an increase of \$108 million or 17.4% over the second quarter of 2008. The loan growth was driven by increased commercial and commercial real-estate production. Total deposits averaged \$768 million in the second quarter of 2009, an increase of \$67 million or 9.5% over the same 2008 quarter. We believe that uncertainties in the financial markets and the economy have contributed to growth in both money market and demand deposits as consumers have looked for safety in well capitalized community banks like AmeriServ Financial. Additionally, the Company also benefitted from a favorable decline in interest expense caused by the more rapid downward repricing of both deposits and FHLB borrowings due to the market decline in short-term interest rates.

.....**COMPONENT CHANGES IN NET INTEREST INCOME..** Regarding the separate components of net interest income, the Company's total interest income for the first quarter of 2009 increased by \$605,000 when compared to the same 2008 quarter. This increase was due to the \$108 million increase in average loans, but was lessened by a 49 basis point decrease in the earning asset yield to 5.42%. Within the earning asset base, the yield on the total loan portfolio decreased by 57 basis points to 5.72% and reflects the lower interest rate environment in 2009 as the Federal Reserve has reduced the federal funds rate by approximately 200 basis points since last year's second quarter. The total investment securities yield decreased by 17 basis points to 4.15%. The Company took advantage of the positively sloped yield curve in the second quarter of 2008 to position the investment portfolio for better future earnings by selling some of the lower yielding securities in the portfolio at a loss and replacing them with higher yielding securities with a modestly longer duration. The investment portfolio yield reflected the full benefit of this strategy in the second quarter of 2009, which helped reduce the decline in the yield due to overall lower interest rates.

The Company's total interest expense for the second quarter of 2009 decreased by \$600,000 or 13.4% when compared to the same 2008 quarter. This decrease in interest expense was due to a lower cost of funds as the cost of both deposits and borrowings repriced downward with the reductions in short-term interest rates. Specifically, the cost of interest bearing deposits declined by 53 basis points to 2.09%, while the cost of all FHLB borrowings dropped by 165 basis points to 1.22%. This decrease in funding costs more than offset the additional interest expense associated with a \$79 million increase in the volume of interest bearing liabilities due to the previously mentioned deposit growth. Additionally, the Company's funding mix also benefited from a \$5.9 million increase in non-interest bearing demand deposits.

The table that follows provides an analysis of net interest income on a tax-equivalent basis for the three month periods ended June 30, 2009 and June 30, 2008 setting forth (i) average assets, liabilities, and stockholders' equity, (ii) interest income earned on interest earning assets and interest expense paid on interest bearing liabilities, (iii) average yields earned on interest earning assets and average rates paid on interest bearing liabilities, (iv) AmeriServ Financial's interest rate spread (the difference between the average yield earned on interest earning assets and the average rate paid on interest bearing liabilities), and (v) AmeriServ Financial's net interest margin (net interest income as a percentage of average total interest earning assets). For purposes of these tables, loan balances do include non-accrual loans, and interest income on loans includes loan fees or amortization of such fees which have been deferred, as well as, interest recorded on certain non-accrual loans as cash is received. Additionally, a tax rate of 34% is used to compute tax-equivalent yields.

**Three months ended June 30** (In thousands, except percentages)

	<u>2009</u>		<u>2008</u>		
	Interest		Interest		
	Average	Income/ Yield/	Average	Income/	Yield/
	<u>Balance</u>	<u>Expense Rate</u>	<u>Balance</u>	<u>Expense</u>	<u>Rate</u>
Interest earning assets:					
Loans and loans held for sale,					

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net of unearned income	\$732,568	\$ 10,553	5.72	%	\$624,193	\$ 9,883	6.29 %
Deposits with banks	1,715	1	0.23		446	2	1.77
Short-term investment in money							
market funds	10,579	8	0.29		6,399	38	2.40
Investment securities AFS	130,256	1,337	4.11		126,516	1,342	4.24
Investment securities HTM	<u>14,607</u>	<u>165</u>	4.52		<u>16,974</u>	<u>206</u>	4.85
Total investment securities	<u>144,863</u>	<u>1,502</u>	4.15		<u>143,490</u>	<u>1,548</u>	4.32
<b>Total interest earning</b>							
<b>assets/interest income</b>	889,725	12,064	5.42		774,528	11,471	5.91
Non-interest earning assets:							
Cash and due from banks	14,005				17,056		
Premises and equipment	9,122				9,101		
Other assets	72,074				69,798		
Allowance for loan losses	<u>(11,101)</u>				<u>(7,350)</u>		
<b>TOTAL ASSETS</b>	<u>\$973,825</u>				<u>\$863,133</u>		
Interest bearing liabilities:							
Interest bearing deposits:							
Interest bearing demand	\$ 61,316	\$ 64	0.42	%	\$ 65,495	\$ 154	0.94 %
Savings	72,988	138	0.76		70,976	134	0.76
Money markets	171,019	704	1.65		105,308	548	2.09
Other time	<u>347,422</u>	<u>2,498</u>	2.88		<u>350,229</u>	<u>3,024</u>	3.46
Total interest bearing deposits	652,745	3,404	2.09		592,008	3,860	2.62
Short-term borrowings:							
Federal funds purchased,							
securities sold under							
agreements to repurchase and							
other short-term borrowings	52,358	71	0.55		35,822	209	2.30
Advances from Federal							
Home Loan Bank	13,840	129	3.74		11,822	135	4.60
Guaranteed junior subordinated							
deferrable interest debentures	<u>13,085</u>	<u>280</u>	8.57		<u>13,085</u>	<u>280</u>	8.57
<b>Total interest bearing</b>							
<b>liabilities/interest expense</b>	732,028	3,884	2.13		652,737	4,484	2.76
Non-interest bearing liabilities:							
Demand deposits	115,248				109,316		

Other liabilities	11,914			9,220	
Shareholders' equity	<u>114,635</u>			<u>91,860</u>	
<b>TOTAL LIABILITIES AND</b>					
<b>SHAREHOLDERS' EQUITY</b>					
	<u>\$973,825</u>			<u>\$863,133</u>	
Interest rate spread		3.29			3.15
Net interest income/					
Net interest margin	8,180	3.66	%	6,987	3.58 %
Tax-equivalent adjustment	<u>(9)</u>			<u>(21)</u>	
<b>Net Interest Income</b>	<u>\$ 8,171</u>			<u>\$ 6,966</u>	

**..PROVISION FOR LOAN LOSSES.....** The Company strengthened its allowance for loan losses in the second quarter of 2009 in response to an increase in non-performing loans. Specifically, non-performing assets increased by \$9.6 million from \$5.1 million or 0.70% of total loans at March 31, 2009 to \$14.7 million or 1.98% of total loans at June 30, 2009. (See the loan quality section of this MD &A for more specific discussion on the credits causing the increase.) As a result of this increase, the Company recorded a \$3.3 million provision for loan losses in the second quarter of 2009 compared to a \$1.4 million provision in the second quarter of 2008, an increase of \$1.9 million. When determining the provision for loan losses, the Company considers a number of factors, some of which include periodic credit reviews, non-performing, delinquency and charge-off trends, concentrations of credit, loan volume trends and broader local and national economic trends. In addition to the higher level of non-performing loans, the increased loan loss provision in 2009 was also caused by the Company's decision to strengthen its allowance for loan losses due to the downgrade of the rating classification of several performing commercial loans and uncertainties in the local and national economies. The Company's net charge-offs in the second quarter of 2009 amounted to \$355,000 or 0.19% of total loans. This amount was lower than the net charge-offs of \$721,000 or 0.46% of total loans experienced in the second quarter of 2008. Overall, the allowance for loan losses provided 100% coverage of non-performing loans and was 1.84% of total loans at June 30, 2009 compared to 264% of non-performing loans and 1.26% of total loans at December 31, 2008.

**.....NON-INTEREST INCOME.....**Non-interest income for the second quarter of 2009 totaled \$3.5 million; a decrease of \$1.9 million or 34.7% from the second quarter 2008 performance. Factors contributing to this reduced level of non-interest income in 2009 included:

\* a \$1.7 million decline in Bank owned life insurance revenue as it returned to a more typical level in 2009 as the 2008 revenue was impacted by the payment of \$1.6 million in death claims.

\* a \$365,000 decline in trust and investment advisory fees due to reductions in the market value of assets managed due to lower equity and real estate values in the second quarter of 2009.



\* a \$63,000 gain realized in the second quarter of 2009 on the sale of investment securities as the Company took advantage of market opportunities to profitably sell a security that was experiencing rapid prepayments. This compares to a \$137,000 loss realized in the second quarter of 2008 for a net favorable shift of \$200,000. The 2008 loss resulted from a strategy designed to position the investment portfolio for better future earnings by selling some of the lower yielding securities in the portfolio at a loss and replacing them with higher yielding securities with a modestly longer duration.

.....**NON-INTEREST EXPENSE**.....Non-interest expense for the second quarter of 2009 totaled \$9.6 million and increased by \$611,000 or 6.8% from the prior year's second quarter. Factors contributing to the higher non-interest expense in 2009 included:

\* FDIC deposit insurance expense has increased by \$671,000 due to the recognition of a \$435,000 expense for a special five basis point assessment, mandated for all banks, that was accrued in the second quarter of 2009. The remainder of increase reflects higher recurring insurance premiums for the bank due to the need to strengthen the deposit insurance fund.

\* Salaries and benefits expense increased by \$171,000 or 3.6% due to greater salary costs as a result of merit increases and higher pension expense.

\* Other expenses increased by \$161,000 due primarily to greater costs associated with other real estate owned properties.

\* Core deposit amortization expense decreased by \$216,000 in the second quarter of 2009 as a branch core deposit intangible was fully amortized by the end of the first quarter of 2009.

**SIX MONTHS ENDED JUNE 30, 2009 VS. SIX MONTHS ENDED JUNE 30, 2008**

.....**PERFORMANCE OVERVIEW**.....The following table summarizes some of the Company's key performance indicators (in thousands, except per share and ratios).

	Six months ended <u>June 30, 2009</u>	Six months ended <u>June 30, 2008</u>
Net income (loss)	\$ (406)	\$ 2,745

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Diluted earnings (loss) per share	(0.04)	0.13
Return on average assets (annualized)	(0.08)%	0.63%
Return on average equity (annualized)	(0.72)%	6.04%

The Company reported a net loss of \$406,000 or \$0.04 per diluted common share for the first half of 2009. This represents a decrease of \$3.2 million from the first six months of 2008 net income of \$2.7 million or \$0.13 per diluted common share. Diluted earnings per share declined more significantly than net income due to the preferred dividend requirement on the CPP preferred stock in 2009, which amounted to \$522,000 and reduced the amount of net income available to common shareholders. An increased provision for loan losses and reduced non-interest income were the main factors causing the decrease in net income in 2009. These negative items more than offset strong growth in net interest income due to increased loans outstanding and effective balance sheet management in a declining interest rate environment.

.....**NET INTEREST INCOME AND MARGIN**..... The following table compares the Company's net interest income performance for the first six months of 2009 to the first six months of 2008 (in thousands, except percentages):

	Six months ended	Six months ended		
	<u>June 30, 2009</u>	<u>June 30, 2008</u>	<u>Change</u>	<u>% Change</u>
Interest income	\$ 23,990	\$ 23,732	\$ 258	1.1%
Interest expense	<u>7,678</u>	<u>10,031</u>	<u>(2,353)</u>	(23.5)
Net interest income	<u>\$ 16,312</u>	<u>\$ 13,701</u>	<u>\$ 2,611</u>	19.1
Net interest margin	3.69%	3.45%	0.24	N/M
N/M - not meaningful				

The Company's net interest income in the first six months of 2009 increased by \$2.6 million or 19.1% from the prior year's first six months and the net interest margin rose by 24 basis points to 3.69% over the same comparative period. The increased net interest income and margin resulted from a combination of good balance sheet growth and the pricing benefits achieved from a steeper positively sloped yield curve. Specifically, total loans averaged \$723 million in the first six months of 2009, an increase of \$94 million or 15.0% over the first six months of 2008. Total deposits averaged \$741 million in the first six months of 2009, an increase of \$43 million or 6.2% over the same 2008 period. The Company also benefitted from the cost of funds declining at a faster pace than the earning asset yield in 2009. Specifically, effective balance sheet management strategies caused the cost of funds to decrease by 88 basis points, while the earning asset yield dropped by a lesser amount of 55 basis points.

.....**COMPONENT CHANGES IN NET INTEREST INCOME**.. Regarding the separate components of net interest income, the Company's total interest income for the first six months of 2009 increased by \$258,000 when compared to the same 2008 period. This increase was due to \$92 million of growth in earning assets, which more than offset a 55

basis point decrease in the earning asset yield to 5.45%. Within the earning asset base, the yield on the total loan portfolio decreased by 67 basis points to 5.77% and reflects the lower interest rate environment in 2009 as the Federal Reserve has reduced the federal funds rate by approximately 300 basis points since 2008. The total investment securities yield decreased by seven basis points to 4.19% while the yield on short-term money market funds dropped by 233 basis points to 0.40%. The yield on both of these products was also impacted by the lower interest rate environment in 2009.

The \$92 million or 11.6% increase in the volume of average earning assets was due to a \$94 million or 15.0% increase in average loans, partially offset by a \$9 million or 5.5% decrease in average investment securities. This loan growth was driven by increased commercial real estate loans as a result of successful new business development efforts, particularly in the suburban Pittsburgh market. The Company has found increased commercial lending opportunities in the Pittsburgh market due to the retrenchment of several larger competitors as a result of the turmoil in the financial markets. This loan growth caused the Company's loan to deposit ratio to average 97.6% in the first six months of 2009 compared to 90.1% in the first half of 2008. The decline in investment securities was caused by the call of certain agency securities and ongoing cash flow from mortgage-backed securities. The Company has elected to utilize this cash from lower yielding investment securities to fund higher yielding loans in an effort to improve the Company's earning asset yield and net interest margin.

The Company's total interest expense for the first six months of 2009 decreased by \$2.4 million or 23.5% when compared to the same 2008 period. This decrease in interest expense was due to a lower cost of funds as the cost of both deposits and borrowings repriced downward with the reductions in short-term interest rates. Specifically, the cost of interest bearing deposits declined by 72 basis points to 2.14%, while the cost of all FHLB borrowings dropped by 219 basis points to 1.05%. This decrease in funding costs more than offset the additional interest expense associated with a \$58 million increase in the volume of interest bearing liabilities. Additionally, the Company's funding mix also benefited from a \$4.3 million increase in non-interest bearing demand deposits.

The table that follows provides an analysis of net interest income on a tax-equivalent basis for the six month periods ended June 30, 2009 and June 30, 2008. For a detailed discussion of the components and assumptions included in the table, see the paragraph before the quarterly table on page 22.

**Six months ended June 30** (In thousands, except percentages)

	<u>2009</u>			<u>2008</u>		
	Average	Interest	Yield/	Average	Interest	Yield/
	<u>Balance</u>	<u>Income/</u>	<u>Rate</u>	<u>Balance</u>	<u>Income/</u>	<u>Rate</u>
		<u>Expense</u>			<u>Expense</u>	
Interest earning assets:						
Loans and loans held for sale,						
net of unearned income	\$723,410	\$ 20,913	5.77 %	\$629,003	\$ 20,366	6.44 %
Deposits with banks	1,731	2	0.23	395	8	4.06
Short-term investment in money						
market funds	11,051	22	0.40	6,402	87	2.73
Federal funds sold	28	-	0.19	212	4	3.50
Investment securities AFS	131,369	2,735	4.07	137,687	2,914	4.16
Investment securities HTM	<u>15,295</u>	<u>338</u>	4.42	<u>17,587</u>	<u>444</u>	5.05
Total investment securities	<u>146,664</u>	<u>3,073</u>	4.19	<u>155,274</u>	<u>3,358</u>	4.26
<b>Total interest earning</b>						
<b>assets/interest income</b>	882,884	24,010	5.45	791,286	23,823	6.00
Non-interest earning assets:						
Cash and due from banks	14,747			17,495		
Premises and equipment	9,284			8,993		
Other assets	71,539			69,766		
Allowance for loan losses	<u>(10,123)</u>			<u>(7,329)</u>		
<b>TOTAL ASSETS</b>	<u>\$968,331</u>			<u>\$880,211</u>		
Interest bearing liabilities:						
Interest bearing deposits:						
Interest bearing demand	\$ 61,836	\$ 139	0.45 %	\$ 64,902	\$ 376	1.16 %
Savings	72,373	272	0.76	69,822	265	0.76
Money markets	156,231	1,285	1.66	104,744	1,245	2.38
Other time	<u>336,821</u>	<u>4,963</u>	2.97	<u>348,681</u>	<u>6,474</u>	3.72
Total interest bearing deposits	627,261	6,659	2.14	588,149	8,360	2.86
Short-term borrowings:						
Federal funds purchased,						
securities sold under						
agreements to repurchase and						
other short-term borrowings						

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	73,629	200	0.54	56,409	840	2.95
Advances from Federal						
Home Loan Bank	13,847	259	3.76	11,770	271	4.62
Guaranteed junior subordinated deferrable interest debentures						
	<u>13,085</u>	<u>560</u>	8.57	<u>13,085</u>	<u>560</u>	8.57
<b>Total interest bearing</b>						
<b>liabilities/interest expense</b>	727,822	7,678	2.13	669,413	10,031	3.01
Non-interest bearing liabilities:						
Demand deposits	114,273			109,980		
Other liabilities	12,090			9,374		
Shareholders' equity	<u>114,146</u>			<u>91,444</u>		
<b>TOTAL LIABILITIES AND</b>						
<b>SHAREHOLDERS' EQUITY</b>	<u>\$968,331</u>			<u>\$880,211</u>		
Interest rate spread			3.33			2.99
Net interest income/						
Net interest margin		16,332	3.69 %		13,792	3.45 %
Tax-equivalent adjustment		<u>(20)</u>			<u>(42)</u>	
<b>Net Interest Income</b>		<u>\$16,312</u>			<u>\$13,750</u>	

**..PROVISION FOR LOAN LOSSES.....** The Company recorded a \$5.1 million provision for loan losses in the first six months of 2009 compared to a \$1.5 million provision in the first six months of 2008, an increase of \$3.6 million. The Company's decision to strengthen its allowance for loan losses in 2009 was due to an increase in both non-performing assets and classified loans amid the weakening economic environment. (See further discussion in the loan quality section of this MD&A.) For the six month period ended June 30, 2009, net charge-offs have amounted to \$404,000 or 0.11% of total loans compared to net charge-offs of \$814,000 or 0.26% of total loans for the same six month period in 2008. The Company has no direct exposure to sub-prime mortgage loans in either its loan or investment portfolios.

**.....NON-INTEREST INCOME.....** Non-interest income for the first six months of 2009 totaled \$7.1 million; a decrease of \$2.1 million or 23.2% from the first six months 2008 performance. Factors contributing to this reduced level of non-interest income in 2009 included:

\* a \$1.7 million decline in Bank owned life insurance revenue as it returned to a more typical level in 2009 as the 2008 revenue was impacted by the payment of \$1.6 million in death claims.

\* a \$685,000 decline in trust and investment advisory fees due to reductions in the market value of assets managed due to lower equity and real estate values in the first six months of 2009.

\* a \$158,000 decrease in deposit service charges due to a reduced level of overdraft fees in the first six months of 2009.

\* a \$71,000 or 33.8% increase in gains realized on residential mortgage loan sales into the secondary market in the first six months of 2009. As a result of increased mortgage purchase and refinance activity in the Company's primary market, there were \$36 million of residential mortgage loans sold into the secondary market in the first six months of 2009 compared to \$19 million in the first half of 2008.

.....**NON-INTEREST EXPENSE**.....Non-interest expense for the first six months of 2009 totaled \$18.8 million and increased by \$994,000 or 5.6% from the prior year's first six months. Factors contributing to the higher non-interest expense in 2009 included:

\* a \$681,000 increase in FDIC deposit insurance expense due to the recognition of a \$435,000 expense for a special five basis point assessment, mandated for all banks, and higher recurring insurance premiums due to the need to strengthen the deposit insurance fund.

\* a \$433,000 increase in salaries and employee benefits expense due to merit increases, increased incentive compensation and higher pension expense.

\* a \$114,000 increase in professional fees due to higher legal and recruitment fees in 2009.

\* a \$324,000 decrease in core deposit amortization as a branch core deposit intangible was fully amortized by the end of the first quarter of 2009.

.....**INCOME TAX EXPENSE**.....The Company recorded an income tax benefit of \$128,000 in the first six months of 2009 which reflects an estimated effective tax rate of approximately 24.0%. The income tax expense recorded in the first six months of 2008 was \$808,000 and reflected an effective tax rate of approximately 22.7%. The Company's

deferred tax asset declined to \$12.5 million at June 30, 2009 due to the ongoing utilization of net operating loss carryforwards and improved market value of the AFS investment portfolio.

**..SEGMENT RESULTS.** Retail banking's net income contribution was \$96,000 in the second

quarter and \$473,000 for the first six months of 2009 compared to \$1.3 million and \$1.7 million for the same comparable periods of 2008. The lower 2009 net income performance is reflective of the increased FDIC insurance premiums, reduced income from BOLI and a higher provision for loan losses. These negative items more than offset increased net interest income resulting from the growth in deposits achieved in 2009.

The commercial lending segment reported for 2009 a net loss for the second quarter of \$1.3 million and a six month net loss of \$1.6 million compared to \$188,000 of net income earned in the second quarter and \$918,000 for the first six months of 2008. The reduced earnings in 2009 was caused by an increased provision for loan losses due to the previously discussed strengthening of the allowance for loan losses as a result of the deterioration in asset quality experienced in 2009. This higher provision more than offset an increased level of net interest income due to the strong commercial real-estate loan growth achieved over the past year.

The trust segment's net income contribution in the second quarter amounted to \$104,000 and \$248,000 for the first six months of 2009 compared to \$352,000 and \$815,000 for the same 2008 periods. The major reason for the decrease between years was due to less wealth management revenue as a result of fewer assets under management due to the declines experienced in the equity and real estate markets during the past year. This segment has also experienced an increase in non-interest expenses due to increased personnel costs and higher legal and consulting fees.

The investment/parent segment reported net income of \$180,000 in the second quarter and \$493,000 for the first six months of 2009, which was an improvement over the net losses of \$370,000 realized in the second quarter and \$714,000 for the first six months of 2008. The Company's balance sheet positioning allowed it to benefit from the significant Federal Reserve reductions in short-term interest rates and the return to a more traditional positively sloped yield curve, which has caused net interest income in this segment to increase. Also, the Company realized \$164,000 of investment security gains in 2009 compared to losses of \$137,000 realized in 2008.

**.....BALANCE SHEET.....**The Company's total consolidated assets were \$979 million at June 30, 2009, which was modestly up by \$12.0 million or 1.2% from the \$967 million level at December 31, 2008. The Company's loans totaled \$740 million at June 30, 2009, an increase of \$32.5 million or 4.6% as a result of continued growth in the commercial loan portfolio. Note that the Company's commercial loan pipelines have begun to slow as we enter the third quarter so we expect to see the rate of loan growth decline in the second half of 2009. Investment securities and short-term money market investments declined by \$14.6 million so far in 2009 due to principal repayments in the mortgage backed securities portfolio and \$4.7 million of investment security sales in the first six months of 2009. The Company has elected to utilize this cash to fund loan growth.

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The Company's deposits totaled \$784 million at June 30, 2009, which was \$88.9 million or 12.8% higher than December 31, 2008, due to an increase in money market deposits and certificates of deposit. We believe that uncertainties in the financial markets and the economy have contributed to growth in our deposits as consumers have looked for safety in well capitalized community banks like AmeriServ Financial. As a result of this deposit growth, we were able to reduce short-term FHLB borrowings by \$76.1 million during the first six months of 2009. Total FHLB borrowings now represent 5.9% of total assets compared to 13.8% at December 31, 2008. The Company's total shareholders' equity has decreased by \$372,000 since year-end 2008 mainly due to the net loss reported for the first half of 2009. The Company continues to be considered well capitalized for regulatory purposes with an asset leverage ratio at June 30, 2009 of 11.61%. The Company's tangible book value per common share at June 30, 2009 was \$3.73, and its tangible common equity to tangible assets ratio was 8.17%.

.....**LOAN QUALITY**.....The following table sets forth information concerning the Company's loan delinquency, non-performing assets, classified assets and restructured loans (in thousands, except percentages):

	June 30, <u>2009</u>	December 31, <u>2008</u>	June 30, <u>2008</u>
Total loan delinquency (past due 30 to 89 days)	\$ 6,843	\$4,396	\$ 3,686
Total non-accrual loans	11,832	3,377	2,609
Total non-performing assets*	14,670	4,572	3,717
Total restructured loans (performing)	10,298	-	-
Total classified loans	25,426	13,235	14,471
Loan delinquency, as a percentage			
of total loans and loans held for sale, net of unearned income	0.93%	0.62%	0.59%
Non-accrual loans, as a percentage			
of total loans and loans held for sale, net of unearned income	1.60	0.48	0.42
Non-performing assets, as a percentage			
of total loans and loans held for sale, net of unearned income, and other real estate owned	1.98	0.65	0.60
Non-performing assets as a percentage			
of total assets	1.50	0.47	0.42



\*Non-performing assets are comprised of (i) loans that are on a non-accrual basis, (ii) loans that are contractually past due 90 days or more as to interest and principal payments, and (iii) other real estate owned.

As a result of the recessionary economy, non-performing assets have trended upward over the past year and now total \$14.7 million or 1.98% of total loans. The following two credits were primarily responsible for the increased level of non-performing assets in the second quarter of 2009: 1) a \$5.9 million commercial loan to an information technology consulting company that is experiencing cash flow difficulties. A \$3.4 million specific reserve has been established against this credit. 2) a \$3.9 million commercial relationship with a paper manufacturer that has ceased operations. This relationship consists of both an asset based line of credit and a commercial mortgage with an 80% government deficiency guarantee. A \$370,000 specific reserve has been established against this relationship. The increase in both classified loans and restructured loans in the first six months of 2009 was largely due to the downgrade of an \$11 million performing commercial loan in the restaurant industry to a substandard rating. The Company restructured this loan at its maturity by entering into a forbearance agreement with the borrower to make reduced payments over a six-month period in an effort to give the borrower greater flexibility to restructure its operations to improve its cash flows during this difficult economic period. The Company has never had any payment delinquency with this borrower.

Overall, loan delinquency levels have trended upward but remain below 1.0% during all periods presented. We continue to closely monitor the portfolio given the recessionary economy and the number of relatively large-sized commercial and commercial real estate loans within the portfolio. As of June 30, 2009, the 25 largest credits represented 31.0% of total loans outstanding.

.....**ALLOWANCE FOR LOAN LOSSES**.....The following table sets forth the allowance for loan losses and certain ratios for the periods ended (in thousands, except percentages):

	June 30, <u>2009</u>	December 31, <u>2008</u>	June 30, <u>2008</u>
Allowance for loan losses	\$13,606	\$8,910	\$7,963
Allowance for loan losses as a percentage of each of the following:			
total loans and loans held for sale, net of unearned income	1.84%	1.26%	1.28%
total delinquent loans (past due 30 to 89 days)	198.83	202.68	216.03
total non-accrual loans	114.99	263.84	305.21
total non-performing assets	92.75	194.88	214.23

The allowance for loan losses provided 115% coverage of non-accrual loans at June 30, 2009 compared to 264% coverage at December 31, 2008, and 305% coverage at June 30, 2008. The decline in coverage between periods reflects the previously discussed increase in non-accrual loans experienced during the second quarter of 2009. The allowance for loan losses to total loans ratio increased to 1.84% since year-end 2008 as the loan loss provision significantly exceeded net charge-offs in the first six months of 2009. The Company decided to build its allowance for loan losses over the past year due to the increase in non-performing loans, the downgrade of the rating classification of several performing commercial loans, and the weakness in the local and national economies.

**.....LIQUIDITY.....**The Bank's liquidity position has been strong during the last several years when the Bank was undergoing a turnaround and a return to traditional community banking. Our core retail deposit base remained stable throughout the early part of this period and has recently shown nice growth, which has been adequate to fund the Bank's operations. Cash flow from maturities, prepayments and amortization of securities was also used to fund the strong net loan growth that the Company has achieved over the past several years. We plan to operate our loan to deposit ratio in a range of 90% to 100%. At June 30, 2009, the bank's loan to deposit ratio was 94.4%.

Liquidity can also be analyzed by utilizing the Consolidated Statement of Cash Flows. Cash and cash equivalents decreased by \$8.3 million from December 31, 2008, to June 30, 2009, due to \$19.6 million of cash used in investing activities and \$2.3 million of cash used in operating activities. This was partially offset by \$13.6 million of cash provided by financing activities. Within investing activities, cash provided by investment security maturities and sales exceeded purchases of new investment securities by \$7.3 million. Cash advanced for new loan fundings and purchases totaled \$96.1 million and was \$26.7 million higher than the \$69.4 million of cash received from loan principal payments and sales. Within financing activities, deposits increased by \$90.5 million, which was used to paydown short-term borrowings by \$76.1 million and help fund the previously mentioned loan growth.

The Parent Company had \$22 million of cash, short-term investments, and securities at June 30, 2009, which was comparable with the year-end 2008 total. We have elected to retain the majority of the \$21 million of funds received from the CPP preferred stock at the Parent Company to provide us with greater liquidity and financial flexibility. Additionally, dividend payments from our subsidiaries also provide ongoing cash to the Parent. At June 30, 2009, the subsidiary bank had \$1.6 million of cash available for immediate dividends to the Parent under the applicable regulatory formulas.

**.....CAPITAL RESOURCES.....**The Company continues to be considered well capitalized as the asset leverage ratio was 11.61% and the Tier 1 capital ratio was 14.31% at June 30, 2009. Note that the impact of other comprehensive loss is excluded from the regulatory capital ratios. At June 30, 2009, accumulated other comprehensive loss amounted to \$3.7 million. The Company's tangible common equity to tangible assets ratio was 8.17% at June 30, 2009. We anticipate that our strong capital ratios should be relatively stable in the second half of 2009 due to the retention of all earnings, which will be offset by preferred dividend requirements and growth of the balance sheet.

Our decision to accept the \$21 million CPP preferred stock investment in December 2008 did strengthen our capital ratios. However as a result of this decision, for a period of three years we are no longer permitted to repurchase stock or declare and pay common dividends without the consent of the U.S. Treasury.

.....**INTEREST RATE SENSITIVITY**.....The following table presents an analysis of the sensitivity inherent in the Company's net interest income and market value of portfolio equity. The interest rate scenarios in the table compare the Company's base forecast, which was prepared using a flat interest rate scenario, to scenarios that reflect immediate interest rate changes of 100 and 200 basis points. Note that we suspended the 200 basis point downward rate shock since it has little value due to the absolute low level of interest rates. Each rate scenario contains unique prepayment and repricing assumptions that are applied to the Company's existing balance sheet that was developed under the flat interest rate scenario.

<u>Interest Rate Scenario</u>	<u>Variability of Net Interest Income</u>	<u>Change In Market Value of Portfolio Equity</u>
200bp increase	5.4%	6.0%
100bp increase	4.6	5.0
100bp decrease	(9.5)	(13.7)

The variability of net interest income is negative in the 100 basis point downward rate scenario as the Company has more exposure to assets repricing downward to a greater extent than liabilities due to the absolute low level of interest rates with the fed funds rate currently at 0.25%. The variability of net interest income is positive in the upward rate shocks as the Company has better diversified its loan portfolio over the past year with more loans now tied to LIBOR.

Also, the Company expects that it will not have to reprice its core deposit accounts up as quickly when interest rates rise. The market value of portfolio equity increases in the upward rate shocks due to the improved value of the Company's core deposit base. Negative variability of market value of portfolio equity occurs in the downward rate shock due to a reduced value for core deposits.

.....**OFF BALANCE SHEET ARRANGEMENTS** ..The Bank incurs off-balance sheet risks in the normal course of business in order to meet the financing needs of its customers. These risks derive from commitments to extend credit and standby letters of credit. Such commitments and standby letters of credit involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. The Company's exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Bank uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending. The Company had various outstanding commitments to extend credit approximating \$124.5 million and standby letters of credit of \$12.7 million as of June 30, 2009.

.....**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**.....The accounting and reporting policies of the Company are in accordance with Generally Accepted Accounting Principles and conform to general practices within the banking industry. Accounting and reporting policies for the allowance for loan losses, goodwill, income taxes, and investment securities are deemed critical because they involve the use of estimates and require significant management judgments. Application of assumptions that differ from actual performance could result in material

changes in the Company's financial position or results of operation.

**Account** Allowance for Loan Losses

**Balance Sheet Reference** Allowance for Loan Losses

**Income Statement Reference** Provision for Loan Losses

### **Description**

The allowance for loan losses is calculated with the objective of maintaining reserve levels 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 credit portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, likelihood of customer default, loss given default, exposure at default, the amounts and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on consumer loans and residential mortgages, and general amounts for historical loss experience. This process also considers economic conditions, uncertainties in estimating losses and inherent risks in the various credit portfolios. All of these factors may be susceptible to significant change. Also, the allocation of the allowance for credit losses to specific loan pools is based on historical loss trends and management's judgment concerning those trends.

Commercial loans and commercial mortgages are the largest category of credits and the most sensitive to changes in assumptions and judgments underlying the determination of the allowance for loan loss. Approximately \$11.9 million, or 87%, of the total allowance for credit losses at June 30, 2009 has been allocated to these two loan categories. This allocation also considers other relevant factors such as actual versus estimated losses, economic trends, delinquencies, concentrations of credit, trends in loan volume, experience and depth of management, examination and audit results, effects of any changes in lending policies and trends in policy, financial information and documentation exceptions. To the extent actual outcomes differ from management estimates, additional provision for credit losses may be required that would adversely impact earnings in future periods.

**Account** Goodwill and core deposit intangibles

**Balance Sheet Reference** Goodwill and core deposit intangibles

**Income Statement Reference** Goodwill impairment and amortization of core deposit intangibles

### **Description**

The Company considers our accounting policies related to goodwill and core deposit intangibles to be critical because the assumptions or judgment used in determining the fair value of assets and liabilities acquired in past acquisitions are subjective and complex. As a result, changes in these assumptions or judgment could have a significant impact on our financial condition or results of operations.

The fair value of acquired assets and liabilities, including the resulting goodwill, was based either on quoted market prices or provided by other third party sources, when available. When third party information was not available, estimates were made in good faith by management primarily through the use of internal cash flow modeling techniques. The assumptions that were used in the cash flow modeling were subjective and are susceptible to significant changes. The Company routinely utilizes the services of an independent third party that is regarded within the banking industry as an expert in valuing core deposits to monitor the ongoing value and changes in the Company's core deposit base. These core deposit valuation updates are based upon specific data provided from statistical analysis of the bank's own deposit behavior to estimate the duration of these non-maturity deposits combined with market interest rates and other economic factors.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. The Company's goodwill relates to value inherent in the banking business and the value is dependent upon the Company's ability to provide quality, cost-effective services in the face of free competition from other market participants on a regional basis. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of the Company's services. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted and the loyalty of the Company's depositors over a longer time frame. The quality and value of a Company's assets is also an important factor to consider when performing goodwill impairment testing. A decline in earnings as a result of a lack of growth or the inability to deliver cost-effective value added services over sustained periods can lead to impairment of goodwill.

Goodwill which has an indefinite useful life is tested for impairment at least annually and written down and charged to results of operations only in periods in which the recorded value is more than the estimated fair value. The Company's testing in 2008 indicated that its goodwill was not impaired. However, deteriorating economic conditions could result in impairment, which would adversely affect earnings in future periods.

**Account** Income Taxes

**Balance Sheet Reference** Deferred Tax Asset and Current Taxes Payable

**Income Statement Reference** Provision for Income Taxes

**Description**

In accordance with the liability method of accounting for income taxes specified in Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes the provision for income taxes is the sum of income taxes both currently payable and deferred. The changes in deferred tax assets and liabilities are determined based upon the changes in differences between the basis of assets and liabilities for financial reporting purposes and the basis of assets and liabilities as measured by the enacted tax rates that management estimates will be in effect when the differences reverse.

In relation to recording the provision for income taxes, management must estimate the future tax rates applicable to the reversal of tax differences, make certain assumptions regarding whether tax differences are permanent or temporary and the related time of expected reversal. Also, estimates are made as to whether taxable operating income in future periods will be sufficient to fully recognize any gross deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable. Alternatively, we may make estimates about the potential usage of deferred tax assets that decrease our valuation allowances. As of June 30, 2009, we believe that all of the deferred tax assets recorded on our balance sheet will ultimately be recovered and no valuation allowances were needed.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes will be due. If we ultimately determine that payment of these amounts is unnecessary, we reverse the liability and recognize a tax benefit during the period in which we determine that the liability is no longer necessary. We record an additional charge in our provision for taxes in the period in which we determine that the recorded tax liability is less than we expect the ultimate assessment to be.

**ACCOUNT** Investment Securities

**BALANCE SHEET REFERENCE** Investment Securities

**INCOME STATEMENT REFERENCE** Net realized gains (losses) on investment securities

## **DESCRIPTION**

Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that security's performance, the creditworthiness of the issuer and the Company's intent and ability to hold the security to recovery. A decline in value that is to be considered to be other-than-temporary is recorded as a loss within non-interest income in the Consolidated Statements of Operation. At June 30, 2009, nearly 100% of the unrealized losses in the available-for-sale security portfolio were comprised of securities issued by Government agencies, U.S. Treasury or Government sponsored agencies. The Company believes the price movements in these securities are dependent upon the movement in market interest rates. The Company's management also maintains the intent and ability to hold securities in an unrealized loss position to the earlier of the recovery of losses or maturity.

## **....FORWARD LOOKING STATEMENT.....**

### **THE STRATEGIC FOCUS:**

The challenge for the future is to improve earnings performance to peer levels through a disciplined focus on community banking and our Trust Company. In accordance with our strategic plan, AmeriServ will maintain its focus as a community bank delivering banking and trust services to the best of our ability. AmeriServ does not intend to succumb to the lure of quick fixes and fancy financial gimmicks. We have seen where that path leads, and have marveled at how many knowledgeable people fall victim. Additionally, we expect to face increased regulatory costs and higher FDIC insurance expense in the future (in the form of both higher regular premiums and special FDIC assessments). Despite these expected challenges, it is our plan to continue to build AmeriServ into a potent banking force in this region and in this industry. Our focus encompasses the following:

**Customer Service** - it is the existing and prospective customer that AmeriServ must satisfy. This means good products and fair prices. But it also means quick response time and professional competence. It means speedy problem resolution and a minimizing of bureaucratic frustrations. AmeriServ continues training and motivating its staff to meet these standards.

**Revenue Growth** - It is necessary for AmeriServ to focus on growing revenues. This means loan growth, deposit growth and fee growth. It also means close coordination between all customer service areas so as many revenue producing products as possible can be presented to existing and prospective customers. The Company's Strategic Plan contains action plans in each of these areas. This challenge will be met by seeking to exceed customer expectations in every area. An examination of the peer bank database provides ample proof that a well executed community banking business model can generate a reliable and rewarding revenue stream.

Expense Rationalization - a quick review of recent AmeriServ financial statements tells the story of a continuing process of trying to rationalize expenses. This has not been a program of broad based cuts, but has been targeted so AmeriServ stays strong but spends less. However, this initiative takes on new importance because it is critical to be certain that future expenditures are directed to areas that are playing a positive role in the drive to improve revenues.

Each of the preceding charges has become the focus at AmeriServ, particularly in the three major customer service, revenue generating areas.

1.

**THE RETAIL BANK** this business unit had a successful 2008 and is positioned to continue to grow. It has a solid array of banking services that includes deposit gathering, consumer lending and residential mortgages. With its broad distribution of community offices in its primary market, this business unit provides a solid foundation for the company to grow from.

2.

**COMMERCIAL LENDING** this business unit is already in a growth mode. It has totally revised procedures and has recruited an experienced professional staff. But it also has the skills and energy to provide financial advice and counsel. The challenge is to shorten response time, to eliminate bureaucracy and to always understand the needs of the customer. This business unit has already proven its value with record loan production in each of the past two years. The challenge is to maintain this momentum, carefully manage asset quality during this recession to limit losses, and to continue working to maximize its potential.

3.

**TRUST COMPANY** the Trust Company has restructured itself into a true 21st Century business model which has improved its marketplace focus. It has a positive investment performance record, which enables it to excel in traditional trust functions such as wealth management. The Trust Company has created a small niche in the vast market of union managed pension funds. Resources will continue to be channeled to the Trust Company so that this kind of creativity can continue to lead to new profit opportunities. However, synergies need to be developed between the Trust Company and West Chester Capital Advisors so that revenue growth can be further enhanced.

This Form 10-Q contains various forward-looking statements and includes assumptions concerning the Company's beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, operations, future results, and prospects, including statements that include the words may, could, should, would, believe, expect, anticipate, intend, plan or similar expressions. These forward-looking statements are based upon current expectations and are subject to risk and uncertainties. In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company provides the following cautionary statement identifying important factors (some of



which are beyond the Company's control) which could cause the actual results or events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.

Such factors include the following: (i) the effect of changing regional and national economic conditions; (ii) the effects of trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; (iii) significant changes in interest rates and prepayment speeds; (iv) inflation, stock and bond market, and monetary fluctuations; (v) credit risks of commercial, real estate, consumer, and other lending activities; (vi) changes in federal and state banking and financial services laws and regulations; (vii) the presence in the Company's market area of competitors with greater financial resources than the Company; (viii) the timely development of competitive new products and services by the Company and the acceptance of those products and services by customers and regulators (when required); (ix) the willingness of customers to substitute competitors products and services for those of the Company and vice versa; (x) changes in consumer spending and savings habits; (xi) unanticipated regulatory or judicial proceedings; and (xii) other external developments which could materially impact the Company's operational and financial performance.

The foregoing list of important factors is not exclusive, and neither such list nor any forward-looking statement takes into account the impact that any future acquisition may have on the Company and on any such forward-looking statement.

**Item 3.....QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.....**The Company manages market risk, which for the Company is primarily interest rate risk, through its asset liability management process and committee, see further discussion in Interest Rate Sensitivity section of this M.D. & A.

**Item 4.....CONTROLS AND PROCEDURES.....**(a) Evaluation of Disclosure Controls and Procedures. The Company's management carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and the operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2009, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer along with the Chief Financial Officer concluded that the Company's disclosure controls and procedures as of June 30, 2009, are effective.

(b) Changes in Internal Controls. There have been no changes in AmeriServ Financial Inc.'s internal controls over financial reporting that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.



## **Part II Other Information**

### **Item 1. Legal Proceedings**

There are no material proceedings to which the Company or any of our subsidiaries are a party or by which, to the Company's knowledge, we, or any of our subsidiaries, are threatened. All legal proceedings presently pending or threatened against the Company or our subsidiaries involve routine litigation incidental to our business or that of the subsidiary involved and are not material in respect to the amount in controversy.

### **Item 1A. Risk Factors**

There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

As a result of the decision by the Company to accept a preferred stock investment under the U.S. Treasury's CPP for a period of three years the Company is no longer permitted to repurchase stock or declare and pay dividends on common stock without the consent of the U.S. Treasury.

### **Item 3. Defaults Upon Senior Securities**

None

### **Item 4. Submission of Matters to a Vote of Security Holders**

The annual meeting of the shareholders of AMERISERV FINANCIAL, Inc. was held on April 28, 2009. The results of the items submitted for a vote were as follows:

<b>Proposal #1</b>	<b>Number of Votes Cast for Class I Director</b>	<b>% of Total Outstanding Shares Voted</b>
J. Michael Adams, Jr.	15,970,645	94.8
Margaret A. O Malley	16,065,892	95.4
Mark E. Pasquerilla	15,924,350	94.5
Thomas C. Slater	15,934,320	94.6
Nedret Vidinli	16,182,762	96.1
<b>Proposal #2</b>	<b>FOR</b>	<b>AGAINST</b>
Amendment of the Articles of Incorporation lowering the Par Value of the Common Stock	15,635,572	998,641
<b>Proposal #3</b>	<b>FOR</b>	<b>AGAINST</b>
Ratify S.R. Snodgrass,A.C. as independent public accountant	16,310,855	290,074
<b>Proposal #4</b>	<b>FOR</b>	<b>AGAINST</b>
An advisory (non-binding) vote on Executive Compensation	15,203,990	1,401,077

**Item 5. Other Information**

None

**Item 6. Exhibits**

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3.1 Articles of Incorporation as amended on January 3, 2005, exhibit 3.1 to 2004 Form 10-K filed on

March 10, 2005

- 3.2 Bylaws, Exhibit 3.2 to the Registrant's Form 8-K filed September 19, 2008.
- 3.3 Certificate of Designation of Rights of Fixed Rate Cumulative Perpetual Preferred Stock, Series D (Incorporated by reference to Exhibit 3.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2008.)
- 15.1 Report of S.R. Snodgrass, A.C. regarding unaudited interim financial statement information.
- 31.1 Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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

AmeriServ Financial, Inc.

Registrant

Date: August 7, 2009

/s/Allan R. Dennison  
Allan R. Dennison  
President and Chief Executive Officer

Date: August 7, 2009

/s/Jeffrey A. Stopko  
Jeffrey A. Stopko  
Executive Vice President and Chief Financial Officer

**STATEMENT OF MANAGEMENT RESPONSIBILITY**

August 7, 2009

To the Stockholders and  
Board of Directors of  
AmeriServ Financial, Inc.

Management of AmeriServ Financial, Inc. and its subsidiaries (the Company) have prepared the consolidated financial statements and other information in the Form 10-Q in accordance with generally accepted accounting principles and are responsible for its accuracy.

In meeting its responsibilities, management relies on internal accounting and related control systems, which include selection and training of qualified personnel, establishment and communication of accounting and administrative policies and procedures, appropriate segregation of responsibilities, and programs of internal audit. These systems are designed to provide reasonable assurance that financial records are reliable for preparing financial statements and maintaining accountability for assets, and that assets are safeguarded against unauthorized use or disposition. Such assurance cannot be absolute because of inherent limitations in any internal control system.

Management also recognizes its responsibility to foster a climate in which Company affairs are conducted with the highest ethical standards. The Company's Code of Conduct, furnished to each employee and director, addresses the importance of open internal communications, potential conflicts of interest, compliance with applicable laws, including those related to financial disclosure, the confidentiality of propriety information, and other items. There is an ongoing program to assess compliance with these policies.

The Audit Committee of the Company's Board of Directors consists solely of outside directors. The Audit Committee meets periodically with management and the Independent Registered Public Accounting Firm to discuss audit,

financial reporting, and related matters. S.R. Snodgrass, A.C. and the Company's internal auditors have direct access to the Audit Committee.

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/s/Allan R. Dennison  
Allan R. Dennison  
President &  
Chief Executive Officer

/s/Jeffrey A. Stopko  
Jeffrey A. Stopko  
Executive Vice President &  
Chief Financial Officer



**Exhibit 99.1**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Audit Committee

AmeriServ Financial, Inc.

We have reviewed the accompanying consolidated balance sheet of AmeriServ Financial, Inc. and its consolidated subsidiaries as of June 30, 2009; the related consolidated statements of operations for the three- and six-month periods ended June 30, 2009 and 2008; and the consolidated statement of cash flows for the six-month periods ended June 30, 2009 and 2008. These consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2008, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated March 2, 2009, we expressed an unqualified opinion on those consolidated financial statements.

/s/S.R. Snodgrass, A.C.

Wexford, PA

August 7, 2009

**Exhibit 15.1**

August 7, 2009

AmeriServ Financial, Inc.

216 Franklin Street

PO Box 520

Johnstown, PA 15907-0520

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited interim financial information of AmeriServ Financial, Inc. for the period ended June 30, 2009, as indicated in our report dated July 31, 2008. Because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, is incorporated by reference in the following Registration Statements:

Registration Statement No. 33-56604 on Form S-3

Registration Statement No. 33-53935 on Form S-8

Registration Statement No. 33-55207 on Form S-8

Registration Statement No. 33-55211 on Form S-8

Registration Statement No. 333-67600 on Form S-8

Registration Statement No. 333-50225 on Form S-3

Registration Statement No. 333-121215 on Form S-3

Registration Statement No. 333-129009 on Form S-3

We are also aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

Sincerely,

/s/S.R. Snodgrass, A.C.

**Exhibit 31.1**

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER  
PURSUANT TO RULES 13a-14 AND 15d-14 OF THE SECURITIES EXCHANGE ACT OF  
1934 AND SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Allan R. Dennison, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AmeriServ Financial, Inc. (ASF);
  
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of ASF as of, and for, the periods presented in this report;
  
4. ASF's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for ASF and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to ASF, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of ASF's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in ASF's internal control over financial reporting that occurred during ASF's most recent fiscal quarter (ASF's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, ASF's internal control over financial reporting; and

5. ASF's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to ASF's auditors and the audit committee of ASF's board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect ASF's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in ASF's internal control over financial reporting.

Date: August 7, 2009

/s/Allan R. Dennison  
Allan R. Dennison  
President & CEO

**Exhibit 31.2**

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

PURSUANT TO RULES 13a-14 AND 15d-14 OF THE SECURITIES EXCHANGE ACT OF

1934 AND SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Jeffrey A. Stopko, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AmeriServ Financial, Inc. (ASF);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of ASF as of, and for, the periods presented in this report;
4. ASF's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for ASF and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to ASF, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of ASF's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in ASF's internal control over financial reporting that occurred during ASF's most recent fiscal quarter (ASF's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, ASF's internal control over financial reporting; and

5. ASF's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to ASF's auditors and the audit committee of ASF's board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect ASF's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in ASF's internal control over financial reporting.

Date: August 7, 2009

/s/Jeffrey A. Stopko  
Jeffrey A. Stopko  
Executive Vice President & CFO



**Exhibit 32.1**

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of AmeriServ Financial, Inc. (the Company ) on Form 10-Q for the period ended June 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the Report ), I, Allan R. Dennison, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

1).

The Report fully complies with the requirements of section 13(a) or 15 (d) of the Securities Exchange Act of 1934;  
and

2).

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/Allan R. Dennison

Allan R. Dennison

President and

Chief Executive Officer

August 7, 2009

**Exhibit 32.2**

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of AmeriServ Financial, Inc. (the Company ) on Form 10-Q for the period ended June 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the Report ), I, Jeffrey A. Stopko, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

1).

The Report fully complies with the requirements of section 13(a) or 15 (d) of the Securities Exchange Act of 1934; and

2).

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/Jeffrey A. Stopko

Jeffrey A. Stopko

Executive Vice President and

Chief Financial Officer

August 7, 2009