

2005 ANNUAL REPORT



**MID PENN BANCORP** INC.

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

A P R O G R E S S I V E , I N D E P E N D E N T C O M M U N I T Y B A N K



John DeSanto, Jr. and Michael Lehmer, Trust Division



17th North Second Street Office



Elizabethtown Office Staff

The year 2005 has been a busy year for Mid Penn Bank. Looking back at the year in review, it was definitely a year of "Making things happen," which included new branching initiatives, new product lines and services, new commitments and new challenges.

In early 2005, Mid Penn Bank converted our existing Check Card portfolio from MasterCard® to Visa® in an effort to be able to offer our customers the increased purchasing power of the Visa brand as well as to provide increased fraud monitoring and fraud protection services. In addition to improving service to our customers,

we were also able to lower our costs with this provider. During this conversion, Mid Penn Bank also upgraded all existing ATMs to offer the newest state-of-the-art functionality, security and operation.

### Annual Report 2005

Mid Penn Bank also introduced our newest product line, equipment leasing, through our newest division, Mid Penn Bank Leasing Services. Leasing has become a practical means for businesses, municipalities, school districts and other organizations to maintain capital, increase buying power by spreading payments out over time, making purchases upfront while waiting for budgetary approvals, etc. Equipment leases may generate energy savings, reduce labor expenses and/or produce additional income for businesses.

Mid Penn Bank Leasing Services operates out of Mid Penn Bank's new regional headquarters located at 5500 Allentown Boulevard, Harrisburg.



Capital Region Headquarters, 5500 Allentown Boulevard, Harrisburg



While proudly maintaining the Bank's corporate headquarters in our original office located in Millersburg, Dauphin County, Pennsylvania since 1868, the Bank realized the need to have a regional presence where the Bank's Commercial Lending Division would be able to establish a base to service the growing commercial loan demand from the Capital Region and surrounding areas. As part of Mid Penn Bank's commitment to the Capital Region, in April 2005, Mid Penn Bank opened our eleventh office at 5500 Allentown Boulevard. This office serves as Mid Penn Bank's Regional Headquarters.

In July 2005, Mid Penn Bank opened our twelfth office at 17 N. Second Street, Harrisburg, in the first floor of the Market Square Plaza building next to the Hilton. This new office presence

## Continued Growth

allows us to service our downtown market of existing professional and business customers, as well as the many consumer financial relationships established by customers who commute to the Capital Region's downtown area for employment.

Operating out of our new Market Square Office, Mid Penn Bank is pleased to provide the expertise of our Trust Department's new Investment Officer, John DeSanto. John has extensive experience, with nearly twenty years related to the financial services industry. Mid Penn Bank's Trust Department, established in 1931, provides estate, investment and asset management services, led by our Senior Trust Officer, Michael Lehmer, who has more than twenty years of financial services, trust and asset management experience.

Also in 2005, Mid Penn Bank purchased a site in Washington Township, where we will re-locate our Elizabethville Office. This new office will provide an efficient, new facility for existing customers, will allow for handicapped access and be compliant with the Americans with Disabilities Act, offer better parking and more security for customers, as well as a state-of-the-art design. This will be Mid Penn Bank's first office designed with the Bank's new office prototype. The existing staff will be relocated to the new office. The office is expected to be completed by the Summer of 2006.



## Dear Shareholder:

It is my pleasure to present the 2005 Annual Report for Mid Penn Bancorp, Inc. The year was one of solid growth, branch expansion and positive trends in earnings. I believe we lived up to our brand promise, "Making things happen for you," and we fully expect to build on this success in 2006 and beyond.

Net income of \$4,603,000 for the year increased from \$4,369,000 the prior year, a gain of 5.4%. Earnings per share of \$1.37 increased from \$1.30 the prior year. Your Bank's return on average equity was 12.87%, compared to 12.73% the prior year. The increase in income was primarily attributable to a strong improvement in net interest income, which increased \$1,665,000 or 13.8% from the prior year. We also experienced a favorable reduction in the loan loss provision from \$725,000 in 2004 to \$225,000 in 2005, primarily as the result of an upgrade in the risk rating of a significant credit.

During 2005, we opened two new offices in the Capital Region, which contributed \$26.5 million in new deposits for the year and \$13.8 million in new loans. We are pleased with the results of the new offices. Total deposits of \$325,274,000 increased by 8.01% in 2005 with the majority of deposit growth resulting from the new Allentown Boulevard and Market Square Offices. In 2006, we will be relocating our Elizabethville Office, which will allow us to take advantage of the growth we anticipate in connection with the opening of a new Wal-Mart store adjacent to the new branch site.

Total assets of \$437,937,000 as of year end 2005 increased by \$34,681,000 or 8.60% from the prior year. We had a solid year for loan growth with net loans increasing by 11.68% over the prior year. The majority of the loan growth was in commercial loans, an area of strong growth for a number of years. Our equipment leasing division, which we launched in 2005, has been well received in the market and has created synergies for our commercial loan business.

Effective January 1, 2006, the Board of Directors appointed two new board members, Robert C. Grubic and William A. Specht, III, both of whom are shareholders and successful business owners and are active in the community. I feel they will represent the shareholders well and will contribute to our continued success.

I would also like to recognize Charles R. Phillips, a director of the Bank from 1979 to 1997, who passed away in June 2005.

Thank you for your continuing support of Mid Penn Bancorp, Inc. Please consider Mid Penn Bank for all your banking needs. We have a full range of banking services, a friendly and helpful staff and a community bank philosophy. We want to continue "Making things happen for you." Please call me at (717) 692-2133, or e-mail me at [adakey@midpennbank.com](mailto:adakey@midpennbank.com), should you have any questions, concerns, suggestions or financial needs.

Sincerely,

A handwritten signature in blue ink that reads "Alan Dahey". The signature is fluid and cursive, written in a professional style.

  
**MID PENN BANCORP**<sub>INC.</sub>  
*Making things happen for you.™*



While proudly maintaining the Bank's corporate headquarters in our original office located in Millersburg, Dauphin County, Pennsylvania since 1868, the Bank realized the need to have a regional presence where the Bank's Commercial Lending Division would be able to establish a base to service the growing commercial loan demand from the Capital Region and surrounding areas. As part of Mid Penn Bank's commitment to the Capital Region, in April 2005, Mid Penn Bank opened our eleventh office at 5500 Allentown Boulevard. This office serves as Mid Penn Bank's Regional Headquarters.

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## Northern Region Locations

**Millersburg** | 349 Union Street • Millersburg, PA 17061 | 717.692.2133

**Elizabethville** | 2 East Main Street • Elizabethville, PA 17023 | 717.362.8147

**Dalmatia** | PO Box 205, School Road • Dalmatia, PA 17017 | 570.758.2711

**Tower City** | 545 East Grand Avenue • Tower City, PA 17980 | 717.647.2157

**Lykens** | 550 Main Street • Lykens, PA 17048 | 717.453.7185

**Halifax** | 3763 Peters Mountain Road • Halifax, PA 17032 | 717.896.8258

**Dauphin** | 1001 Peters Mountain Road • Dauphin, PA 17018 | 717.921.8899

## Capital Region Locations

**Harrisburg** | 4098 Derry Street • Harrisburg, PA 17111 | 717.558.2144

**Harrisburg** | 2615 North Front Street • Harrisburg, PA 17110 | 717.233.7380

**Harrisburg** | 5500 Allentown Boulevard • Harrisburg, PA 17112 | 717.920.1772

**Harrisburg** | 17 North Second Street • Harrisburg, PA 17101 | 717.920.1980

**Mechanicsburg** | 4622 Carlisle Pike • Mechanicsburg, PA 17050 | 717.761.2480

## Mission Statement:

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

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

ANNUAL REPORT 2005



**MID PENN BANCORP**<sup>INC.</sup>

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

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A P R O G R E S S I V E , I N D E P E N D E N T C O M M U N I T Y B A N K



## ANNUAL REPORT 2005

### financial highlights

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## AS OF AND FOR YEARS ENDED DECEMBER 31, 2005 AND 2004

(Dollars in thousands, except per share data.)

	<u>2005</u>	<u>2004</u>	<u>Percent Change</u>
Total Assets.....	\$ 438,110	403,256	+8.64%
Total Deposits.....	325,274	301,144	+8.01%
Net Loans.....	308,133	275,904	+11.68%
Total Investments and Interest Bearing Balances.....	105,427	105,020	+0.39%
Stockholders' Equity.....	36,861	35,272	+4.50%
Net Income.....	4,603	4,369	+5.36%
Earnings Per Share.....	1.37	1.30	+5.38%
Cash Dividend Per Share, historical.....	.80	1.80	-55.56%
Book Value Per Share.....	11.01	10.53	+4.56%
Return on Average Stockholders' Equity.....	12.87%	12.73%	+1.10%
Return on Average Assets.....	1.10%	1.12%	-1.79%
Net Interest Margin.....	3.67%	3.48%	+5.46%
Nonperforming Loans to Total Loans.....	0.76%	0.63%	+20.63%

Per share information has been restated to reflect the retroactive effect of a five percent stock dividend paid in the first quarter of 2006.

Mid Penn Bancorp, Inc.  
Stockholders' Information

		<u>2005</u>		<u>2004</u>		<u>Quarter</u>
		<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	
Market Value Per Share.....	\$	27.70	25.10	31.95	23.75	1st
		25.40	24.60	28.78	27.25	2nd
		27.00	25.35	31.25	27.20	3rd
		25.85	24.20	28.20	25.10	4th

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

Transfer Agent: Registrar and Transfer Company, 10 Commerce Drive, Cranford, NJ 07016-3572.  
Phone: 1-800-368-5948.

Number of Stockholders: At December 31, 2005, there were 1,049 registered stockholders.

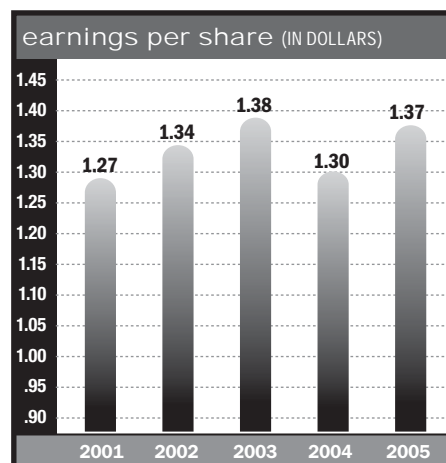
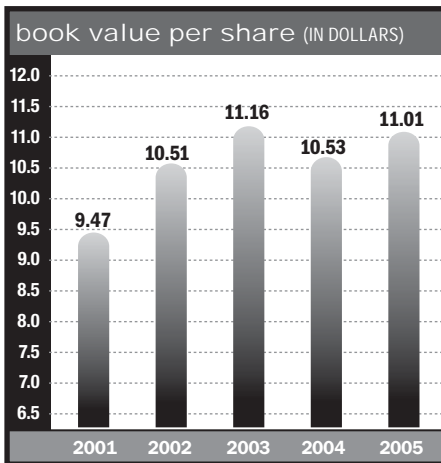
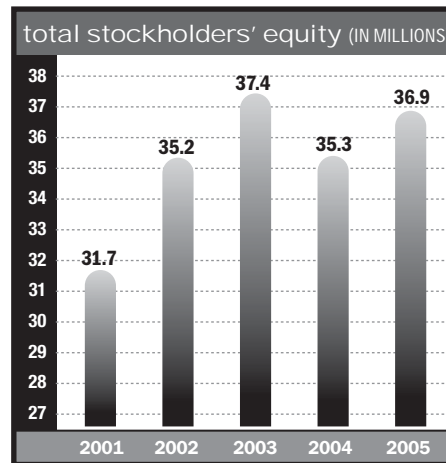
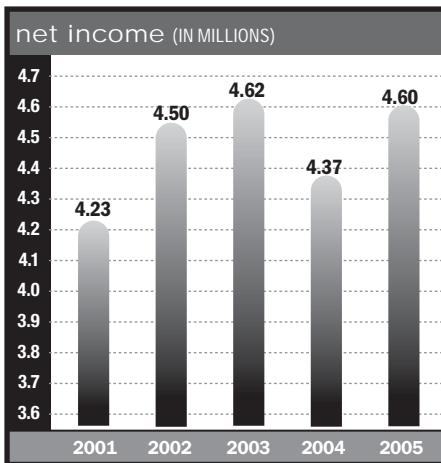
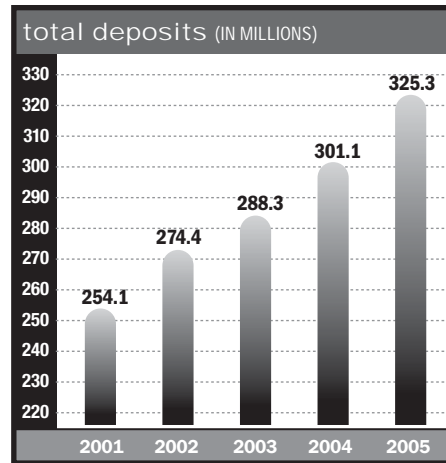
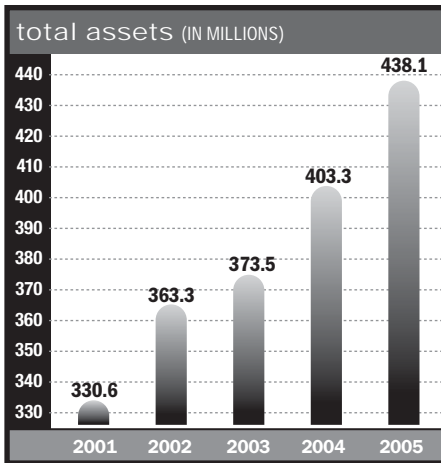
Dividends: A dividend of \$.20 per share was paid during each quarter of 2005 and 2004. A special dividend of \$1.00 per share was also paid in the first quarter of 2004. Mid Penn Bancorp, Inc. plans to continue a quarterly dividend payable in February, May, August and November.

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

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

Annual Meeting: The Annual Meeting of the Stockholders of Mid Penn Bancorp, Inc. will be held at 10:00 a.m. on Tuesday, April 25, 2006, at 349 Union Street, Millersburg, Pennsylvania.

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



Per share information has been restated to reflect the retroactive effect of a five percent stock dividend paid in the first quarter of 2006.

**PARENTE**RANDOLPH*The Power of Ideas*

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

We have audited the accompanying consolidated balance sheet of Mid Penn Bancorp, Inc. and subsidiaries (collectively, the "Corporation") as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mid Penn Bancorp, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the Standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 1, 2006 expressed an unqualified opinion on management's assessment of internal control over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting.



PARENTE RANDOLPH, LLC

Williamsport, Pennsylvania  
February 1, 2006

DECEMBER 31, 2005 AND 2004

(Dollars in thousands, except share data)

	<u>2005</u>	<u>2004</u>
ASSETS		
Cash and due from banks.....	\$ 6,350	6,679
Interest-bearing balances with other financial institutions .....	54,549	60,407
Available-for-sale investment securities.....	50,878	44,613
Loans and leases.....	313,423	281,083
Less:		
Unearned income.....	(1,586)	(1,536)
Allowance for loan and lease losses.....	(3,704)	(3,643)
Net loans.....	<u>308,133</u>	<u>275,904</u>
Bank premises and equipment, net .....	6,334	4,874
Foreclosed assets held for sale.....	458	505
Accrued interest receivable .....	2,269	1,875
Deferred income taxes .....	1,392	982
Goodwill .....	259	259
Core deposit intangible, net .....	235	271
Cash surrender value of life insurance.....	6,402	6,180
Other assets.....	851	707
Total Assets	<u>\$ 438,110</u>	<u>403,256</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand .....	\$ 41,719	37,586
Interest-bearing demand.....	31,686	35,562
Money market.....	61,421	43,116
Savings.....	26,825	28,414
Time.....	<u>163,623</u>	<u>156,466</u>
Total Deposits	325,274	301,144
Short-term borrowings.....	12,342	13,801
Accrued interest payable .....	1,535	1,192
Other liabilities .....	2,260	1,890
Long-term debt .....	<u>59,838</u>	<u>49,957</u>
Total Liabilities	<u>401,249</u>	<u>367,984</u>
Stockholders' Equity:		
Common stock, par value \$1 per share; authorized 10,000,000 shares; 3,207,912 shares issued in 2005 and 2004 .....	3,208	3,208
Additional paid-in capital .....	23,472	23,472
Retained earnings.....	10,486	8,435
Accumulated other comprehensive income.....	231	693
Treasury stock, at cost (19,056 and 19,086 shares at December 31, 2005 and 2004, respectively)	<u>(536)</u>	<u>(536)</u>
Stockholders' Equity, Net	<u>36,861</u>	<u>35,272</u>
Total Liabilities and Stockholders' Equity	<u>\$ 438,110</u>	<u>403,256</u>

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

## FOR YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

(Dollars in thousands, except share data)	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>INTEREST INCOME</b>			
Interest and fees on loans .....	\$ 19,251	16,327	15,470
Interest on interest-bearing balances .....	2,067	1,809	2,099
Interest and dividends on investment securities:			
U.S. Treasury and government agencies .....	801	599	559
State and political subdivision obligations, tax-exempt .....	1,030	1,286	1,783
Other securities .....	92	49	64
Interest on federal funds sold and securities purchased under agreement to resell .....	53	7	9
Total Interest Income	<u>23,294</u>	<u>20,077</u>	<u>19,984</u>
<b>INTEREST EXPENSE</b>			
Interest on deposits .....	6,521	5,624	6,117
Interest on short-term borrowings .....	203	137	128
Interest on long-term debt .....	2,833	2,244	2,189
Total Interest Expense	<u>9,557</u>	<u>8,005</u>	<u>8,434</u>
Net Interest Income	13,737	12,072	11,550
PROVISION FOR LOAN AND LEASE LOSSES .....	225	725	290
Net Interest Income After Provision for Loan and Lease Losses	<u>13,512</u>	<u>11,347</u>	<u>11,260</u>
<b>NONINTEREST INCOME</b>			
Trust department income .....	312	248	202
Service charges on deposits .....	1,348	1,467	1,227
Investment securities gains, net .....	1	475	261
Gain on sale of loans .....	19	0	45
Income on cash surrender value of life insurance .....	222	211	210
Fee income from investment services .....	70	162	21
Fee income from debit card transactions .....	223	169	149
Other income .....	758	725	592
Total Noninterest Income	<u>2,953</u>	<u>3,457</u>	<u>2,707</u>
<b>NONINTEREST EXPENSE</b>			
Salaries and employee benefits .....	5,662	4,918	4,496
Occupancy expense, net .....	594	456	423
Equipment expense .....	734	631	602
Pennsylvania bank shares tax expense .....	259	265	266
Legal and professional expense .....	408	385	284
Marketing and advertising .....	298	185	100
Debit card processing expense .....	154	214	167
Director fees and benefits expense .....	221	196	201
External audit/tax preparation expense .....	132	72	64
Other expenses .....	1,800	1,708	1,496
Total Noninterest Expense	<u>10,262</u>	<u>9,030</u>	<u>8,099</u>
INCOME BEFORE PROVISION FOR INCOME TAXES .....	6,203	5,774	5,868
Provision for income taxes .....	1,600	1,405	1,253
NET INCOME	<u>\$ 4,603</u>	<u>4,369</u>	<u>4,615</u>
EARNINGS PER SHARE	<u>\$ 1.37</u>	<u>1.30</u>	<u>1.38</u>
Weighted Average Number of Shares Outstanding	<u>3,348,299</u>	<u>3,348,310</u>	<u>3,347,929</u>

Earnings per share information has been restated to reflect the retroactive effect of a five percent stock dividend paid in the first quarter of 2006.

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

FOR YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

(Dollars in thousands, except share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2002 .....	\$ 3,057	20,368	10,944	1,357	(522)	35,204
Comprehensive income:						
Net income .....	0	0	4,615	0	0	4,615
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects .....	0	0	0	58	0	58
Total comprehensive income .....						4,673
Cash dividends (\$ .80 per share, historical) .....	0	0	(2,499)	0	0	(2,499)
5% stock dividend (additional 151,411 shares) .....	151	3,104	(3,255)	0	0	0
Purchase of treasury stock (786 shares) .....	0	0	0	0	(17)	(17)
Balance, December 31, 2003 .....	3,208	23,472	9,805	1,415	(539)	37,361
Comprehensive income:						
Net income .....	0	0	4,369	0	0	4,369
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects .....	0	0	0	(722)	0	(722)
Total comprehensive income .....						3,647
Cash dividends (\$1.80 per share, historical) .....	0	0	(5,739)	0	0	(5,739)
Sale of treasury stock (322 shares) .....	0	0	0	0	3	3
Balance, December 31, 2004 .....	3,208	23,472	8,435	693	(536)	35,272
Comprehensive income:						
Net income .....	0	0	4,603	0	0	4,603
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects .....	0	0	0	(462)	0	(462)
Total comprehensive income .....						4,141
Cash dividends (\$ .80 per share, historical) .....	0	0	(2,552)	0	0	(2,552)
Balance, December 31, 2005 .....	\$ 3,208	23,472	10,486	231	(536)	36,861

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

## FOR YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

(Dollars in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating Activities:			
Net income .....	\$ 4,603	4,369	4,615
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses.....	225	725	290
Depreciation .....	579	475	426
Amortization of core deposit intangible .....	36	20	0
Increase in cash surrender value of life insurance .....	(222)	(211)	(210)
Investment securities gains, net.....	(1)	(475)	(261)
(Gain) loss on sale of foreclosed assets .....	(66)	4	(20)
Gain on sale of loans .....	(19)	0	(45)
Loss on disposal of bank premises and equipment .....	2	0	0
Deferred income taxes .....	(173)	(307)	123
Change in accrued interest receivable .....	(394)	(112)	244
Change in other assets.....	(143)	142	380
Change in accrued interest payable.....	343	147	(142)
Change in other liabilities .....	370	540	(301)
Net Cash Provided By Operating Activities	<u>5,140</u>	<u>5,317</u>	<u>5,099</u>
Investing Activities:			
Net decrease (increase) in interest-bearing balances.....	5,858	9,511	(4,431)
Proceeds from the maturity of investment securities .....	4,798	7,979	15,635
Proceeds from the sale of investment securities .....	535	17,195	5,793
Purchases of investment securities .....	(12,297)	(16,305)	(16,313)
Purchase of life insurance .....	0	(1,016)	0
Cash received from business combination.....	0	4,139	0
Proceeds from sale of loans.....	348	0	1,710
Net increase in loans.....	(33,241)	(45,163)	(13,530)
Proceeds from sale of bank premises and equipment .....	40	0	0
Purchases of bank premises and equipment.....	(2,081)	(1,429)	(1,029)
Proceeds from the sale of foreclosed assets.....	571	879	475
Capitalized additions - foreclosed assets .....	0	(147)	0
Net Cash Used In Investing Activities	<u>(35,469)</u>	<u>(24,357)</u>	<u>(11,690)</u>
Financing Activities:			
Net increase in deposits.....	24,130	5,613	13,635
Net (decrease) increase in short-term borrowings .....	(1,459)	4,113	(8,468)
Cash dividends paid .....	(2,552)	(5,739)	(2,499)
Long-term debt repayment .....	(119)	(5,127)	(5,199)
Sale (purchase) of treasury stock .....	0	3	(17)
Long-term borrowings.....	10,000	19,400	8,500
Net Cash Provided By Financing Activities	<u>30,000</u>	<u>18,263</u>	<u>5,952</u>
Net decrease in cash and due from banks.....	(329)	(777)	(639)
Cash and due from banks at beginning of year .....	6,679	7,456	8,095
Cash and due from banks at end of year.....	<u>\$ 6,350</u>	<u>6,679</u>	<u>7,456</u>
Supplemental Disclosures of Cash Flow Information:			
Interest paid.....	\$ 9,214	7,858	8,576
Income taxes paid .....	\$ 1,876	1,385	1,410
Supplemental Noncash Disclosures:			
Loan charge-offs.....	\$ 199	74	349
Transfers to foreclosed assets held for sale .....	\$ 458	124	791
Business Combination:			
Fair value of assets acquired .....	\$ 0	3,054	0
Fair value of liabilities assumed .....	\$ 0	7,193	0

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

**(1) Basis of Presentation**

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

**(2) Nature of Business**

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

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

Mid Penn Investment Corporation is engaged in investing activities.

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

**(3) Summary of Significant Accounting Policies**

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

**(a) Use of Estimates**

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

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

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

**(b) Investment Securities**

Available-for-Sale Securities include debt and restricted equity securities. Debt securities are reported at fair value, with unrealized holding gains and losses excluded from earnings and reported, net of deferred income taxes, as a component of accumulated other comprehensive income (loss) within stockholders' equity. Realized gains and losses on sales of investment securities are computed on the basis of specific identification of the cost of each security. Restricted equity securities are generally carried at cost and evaluated for impairment due to the lack of available market data. Restricted equity securities for which market data is available are reported at fair value. MPB had no trading securities or held-to-maturity securities in 2005, 2004 or 2003.

Declines in the fair value of individual available-for-sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**(c) Loans**

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

**(d) Allowance for Loan and Lease Losses**

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



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

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

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

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

(e) **Bank Premises and Equipment**

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

(f) **Foreclosed Assets Held for Sale**

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

(g) **Income Taxes**

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

(h) **Core Deposit Intangible**

Core deposit intangible is a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. The core deposit intangible is being amortized over an 8 year life on a straight-line basis.

(i) **Goodwill**

Goodwill is the excess of the purchase price over the fair value of assets acquired in connection with a 2004 business acquisition accounted for as a purchase. The potential impairment of goodwill is tested on an annual basis. No impairment of goodwill was recognized in 2005 or 2004.

(j) **Marketing and Advertising Costs**

Marketing and advertising costs are expensed as incurred and were \$298,000 in 2005, \$185,000 in 2004 and \$100,000 in 2003.

(k) **Pensions and Other Postretirement Benefit Plans**

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

(l) **Other Benefit Plan**

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

(m) **Trust Assets and Income**

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

**(n) Earnings Per Share**

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

**(o) Statement of Cash Flows**

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

**(p) Reclassifications**

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

**(4) Comprehensive Income**

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

(Dollars in thousands)	Years Ended December 31,		
	2005	2004	2003
Unrealized holding (losses) gains on available-for-sale securities.....	\$ (699)	(619)	349
Less reclassification adjustment for gains realized in income.....	(1)	(475)	(261)
Net unrealized (losses) gains.....	(700)	(1,094)	88
Income tax benefit (expense).....	238	372	(30)
Net .....	\$ (462)	(722)	58

**(5) Restrictions on Cash and Due from Bank Accounts**

The Bank is required to maintain reserve balances with the Federal Reserve Bank of Philadelphia. The amounts of those required reserve balances were \$480,000 at December 31, 2005 and \$575,000 at December 31, 2004.

Deposits with one financial institution are insured up to \$100,000.

**(6) Investment Securities**

At December 31, 2005 and 2004, amortized cost, fair value, and unrealized gains and losses on investment securities are as follows:

(Dollars in Thousands)	Amortized Cost	Gross Unrealized	Gross Unrealized	Fair Value
		Gains	Losses	
December 31, 2005				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies .....	\$ 14,999	0	305	14,694
Mortgage-backed U.S. government agencies .....	8,114	6	150	7,970
State and political subdivision obligations .....	24,160	847	35	24,972
Restricted equity securities.....	3,253	0	11	3,242
	\$ 50,526	853	501	50,878

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

Estimated fair values of debt securities are based on quoted market prices, where applicable. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments, adjusted for differences between the quoted instruments and the instruments being valued.

Restricted equity securities consist of stock in the Federal Home Loan Bank of Pittsburgh and Atlantic Central Bankers Bank which do not have a readily determinable fair value because their ownership is restricted and they lack a market. Also included in restricted equity securities is an investment in Access Capital Strategies, an equity fund that invests in low to moderate income financing projects. This investment was purchased in 2004 to help fulfill the Bank's regulatory requirement of the Community Reinvestment Act Investment and at December 31, 2005, is reported at fair value.

Investment securities having a fair value of \$36,385,000 at December 31, 2005 and \$29,128,000 at December 31, 2004, were pledged to secure public deposits and other borrowings.

Gains from sales of investment securities amounted to \$1,000 in 2005, \$475,000 in 2004 and \$261,000 in 2003. The proceeds from sales of investment securities were \$535,000 in 2005, \$17,195,000 in 2004 and \$5,793,000 in 2003.

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2005 and 2004.

(Dollars in thousands) December 31, 2005	Less Than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>
Available-for-sale securities:						
U.S. Treasury and U.S. government agencies .....	\$ 6,935	64	7,759	241	14,694	305
Mortgage-backed U.S. government agencies .....	4,082	66	3,637	84	7,719	150
State and political subdivision obligations .....	2,684	32	268	3	2,952	35
Restricted equity securities .....	0	0	238	11	238	11
Total temporarily impaired available-for-sale securities .....	\$ <u>13,701</u>	<u>162</u>	<u>11,902</u>	<u>339</u>	<u>25,603</u>	<u>501</u>

(Dollars in thousands) December 31, 2004	Less Than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>
Available-for-sale securities:						
U.S. Treasury and U.S. government agencies .....	\$ 0	0	7,906	91	7,906	91
Mortgage-backed U.S. government agencies .....	0	0	4,071	87	4,071	87
State and political subdivision obligations .....	0	0	716	13	716	13
Restricted equity securities .....	0	0	246	4	246	4
Total temporarily impaired available-for-sale securities .....	\$ <u>0</u>	<u>0</u>	<u>12,939</u>	<u>195</u>	<u>12,939</u>	<u>195</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis; and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the intent and ability of MPB to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2005 the thirty-two debt securities with unrealized losses have depreciated 2% from their amortized cost basis. These securities are issued by either the U.S. Government or municipalities. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's prior financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

The following is a schedule of the maturity distribution of investment securities at amortized cost and fair value at December 31, 2005:

(Dollars in thousands)	December 31, 2005		December 31, 2004	
	Amortized	Fair	Amortized	Fair
	<u>Cost</u>	<u>Value</u>	<u>Cost</u>	<u>Value</u>
Due in 1 year or less .....	\$ 220	222	1,240	1,252
Due after 1 year but within 5 years .....	11,917	11,861	6,832	6,857
Due after 5 years but within 10 years .....	15,022	15,375	13,240	13,709
Due after 10 years .....	<u>12,002</u>	<u>12,208</u>	<u>13,306</u>	<u>13,922</u>
	39,161	39,666	34,618	35,740
Mortgage-backed securities (avg. life 1.96 years for 2005) .....	8,112	7,970	5,508	5,442
Restricted equity securities .....	<u>3,253</u>	<u>3,242</u>	<u>3,435</u>	<u>3,431</u>
	\$ <u>50,526</u>	<u>50,878</u>	<u>43,561</u>	<u>44,613</u>

**(7) Loans**

A summary of loans at December 31, 2005 and 2004 is as follows:

(Dollars in thousands)	<u>2005</u>	<u>2004</u>
Commercial real estate, construction and land development.....	\$ 219,385	195,549
Commercial, industrial and agricultural .....	31,368	30,940
Real estate - residential .....	44,688	43,914
Consumer.....	<u>17,982</u>	<u>10,680</u>
	\$ <u>313,423</u>	<u>281,083</u>

Net unamortized loan fees and costs of \$350,000 in 2005 and \$344,000 in 2004 were deducted from loans.

Loans and available credit to Bank executive officers, directors, and corporations in which such executive officers and directors have beneficial interests as stockholders, executive officers, or directors aggregated approximately \$2,722,000 at December 31, 2005 and \$2,983,000 at December 31, 2004. New loans extended were \$814,000 in 2005 and \$867,000 in 2004. Net payments on these loans equalled \$1,075,000 during 2005 and \$1,159,000 during 2004. These loans were made on substantially the same basis, including interest rates and collateral as those prevailing for comparable transactions with other borrowers at the same time.

**(8) Allowance for Loan and Lease Losses**

Changes in the allowance for loan and lease losses for the years 2005, 2004, and 2003 are summarized as follows:

	(Dollars in thousands)		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Balance, January 1 .....	\$ 3,643	2,992	3,051
Provision for loan losses .....	225	725	290
Loans charged off .....	(199)	(121)	(409)
Recoveries on loans charged off.....	<u>35</u>	<u>47</u>	<u>60</u>
Balance, December 31.....	\$ <u>3,704</u>	<u>3,643</u>	<u>2,992</u>

The recorded investment in loans that are considered impaired amounted to \$1,126,000, \$1,013,000 and \$439,000 on December 31, 2005, December 31, 2004 and December 31, 2003, respectively. By definition, impairment of a loan is considered when, based on current information and events, it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. The allowance for loan and lease losses related to loans classified as impaired amounted to approximately \$150,000 at December 31, 2005 and \$126,000 at December 31, 2004. All impaired loans at the end of 2005 and 2004 had related allowances. The average balances of these loans amounted to approximately \$1,404,000, \$945,000 and \$983,000 for the years 2005, 2004 and 2003, respectively. The Bank recognizes interest income on impaired loans on a cash basis. The following is a summary of cash receipts on these loans and how they were applied in 2005, 2004 and 2003.

(Dollars in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Cash receipts applied to reduce principal balance .....	\$ 23	36	4
Cash receipts recognized as interest income .....	<u>15</u>	<u>3</u>	<u>0</u>
Total cash receipts.....	\$ <u>38</u>	<u>39</u>	<u>4</u>

Loans which were past due 90 days or more for which interest continued to be accrued amounted to approximately \$1,002,000 at December 31, 2005 and \$394,000 at December 31, 2004. Total nonaccrual loans amounted to \$1,773,000 at December 31, 2005 and \$873,000 at December 31, 2004. The Bank has no commitments to loan additional funds to borrowers with impaired or nonaccrual loans.

**(9) Bank Premises and Equipment**

At December 31, 2005 and 2004, bank premises and equipment are as follows:

(Dollars in thousands)	<u>2005</u>	<u>2004</u>
Land .....	\$ 1,823	1,288
Buildings.....	5,172	4,732
Furniture and fixtures .....	5,881	4,966
Leasehold improvements.....	<u>133</u>	<u>0</u>
	13,009	10,986
Less accumulated depreciation.....	<u>6,675</u>	<u>6,112</u>
	\$ <u>6,334</u>	<u>4,874</u>

Depreciation expense was \$579,000 in 2005, \$475,000 in 2004 and \$426,000 in 2003.

**(10) Deposits**

At December 31, 2005 and 2004, time deposits in denominations of \$100,000 or more amounted to \$34,219,000 and \$27,883,000, respectively. Interest expense on such certificates of deposit amounted to approximately \$1,036,000, \$830,000, and \$873,000 for the years ended December 31, 2005, 2004 and 2003, respectively. Time deposits at December 31, 2005, mature as follows: (in thousands) 2006, \$21,351; 2007, \$6,297; 2008, \$2,658; 2009, \$962; 2010, \$2,345 thereafter, \$606.

Deposits and other funds from related parties held by MPB at December 31, 2005 and 2004 amounted to approximately \$5,430,000 and \$6,133,000, respectively.

**(11) Short-term Borrowings**

Short-term borrowings as of December 31, 2005 and 2004 consisted of:

(Dollars in thousands)	2005	2004
Federal funds purchased .....	\$ 5,000	10,400
Repurchase agreements .....	6,899	2,928
Treasury, tax and loan notes .....	443	473
	<u>\$ 12,342</u>	<u>13,801</u>

The weighted average interest rate on total short-term borrowings outstanding was 4.22% at December 31, 2005 and 2.25% at December 31, 2004.

Federal funds purchased represent overnight funds. Securities sold under repurchase agreements generally mature between one day and one year. Treasury, tax and loan notes are open-ended interest bearing notes payable to the U.S. Treasury upon call. All tax deposits accepted by the Bank are placed in the Treasury note option account. The due to broker balance represents previous day balances transferred from deposit accounts under a sweep account agreement. The Bank also has unused lines of credit with several banks amounting to \$21,748,000 dollars at December 31, 2005.

**(12) Long-term Debt**

The Bank is a member of the Federal Home Loan Bank of Pittsburgh (FHLB) and through its membership, the Bank can access a number of credit products which are utilized to provide various forms of liquidity. As of December 31, 2005 and 2004, the Bank had long-term debt in the amount of \$59,838,000 and \$49,957,000, respectively, consisting of:

(Dollars in thousands)	At December 31,	
	2005	2004
Loans maturing in 2006 with rates ranging from 2.17% to 6.21% .....	\$ 10,000	10,000
Loans maturing in 2007 at a rate of 3.71% .....	5,000	5,000
Loans maturing in 2008 with rates ranging from 3.08% to 3.80% .....	15,000	5,000
Loans maturing in 2009 with rates ranging from 4.22% to 7.24% .....	12,000	12,000
Loans maturing in 2010 with rates ranging from 6.28% to 6.71% .....	10,000	10,000
Loans maturing in 2013 with rates ranging from 4.08% to 4.75% .....	3,500	3,500
Loans maturing in 2026 at a rate of 4.80% .....	4,245	4,362
Loans maturing in 2027 at a rate of 6.71% .....	93	95
Total Long-term Debt	<u>\$ 59,838</u>	<u>49,957</u>

The aggregate amounts of maturities of long-term debt subsequent to December 31, 2005 are \$10,125,000 (2006), \$5,131,000 (2007), \$15,138,000 (2008), \$12,145,000 (2009), \$10,152,000 (2010), \$7,147,000 thereafter. \$4,700,000 of the Bank's investments as well as the Bank's mortgage loan portfolio are pledged to secure FHLB borrowings.

**(13) Pension and Other Postretirement Benefit Plans**

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

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

The significant aspects of each plan are as follows:

**(a) Health Insurance**

For full-time employees who retire after at least 20 years of service, MPB will pay premiums for major medical insurance (as provided to active employees) for a period ending on the earlier of the date the participant obtains other employment where major medical coverage is available or the date of the participant's death; however, in all cases payment of medical premiums by MPB will not exceed five years. If the retiree becomes eligible for Medicare within the five year period beginning on his/her retirement date, the Bank may pay, at its discretion, premiums for 65 Special coverage or a similar supplemental coverage. After the five year period has expired, all MPB paid benefits cease; however, the retiree may continue coverage through the Bank at his/her own expense.

(b) **Life Insurance**

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

(c) **Retirement Plan**

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

The following tables provide a reconciliation of the changes in the plan's health and life insurance benefit obligations and fair value of plan assets for the years ended December 31, 2005 and 2004 and a statement of the funded status at December 31, 2005 and 2004:

(Dollars in thousands)	December 31,	
	<u>2005</u>	<u>2004</u>
Change in benefit obligations:		
Benefit obligations, January 1 .....	\$ 646	501
Service cost .....	43	38
Interest cost .....	36	31
Actuarial loss .....	16	92
Benefit payments .....	(21)	(16)
Benefit obligations, December 31 .....	<u>\$ 720</u>	<u>646</u>
Change in fair value of plan assets:		
Fair value of plan assets, January 1 .....	\$ 0	0
Employer contributions .....	21	16
Benefit payments .....	(21)	(16)
Fair value of plan assets, December 31 .....	<u>\$ 0</u>	<u>0</u>

(Dollars in thousands)	December 31,	
	<u>2005</u>	<u>2004</u>
Funded status:		
Excess of the benefit obligation over the value of plan assets .....	\$ (720)	(646)
Unrecognized transition obligation .....	103	117
Unrecognized loss (gain) .....	20	4
Net amount recognized .....	<u>\$ (597)</u>	<u>(525)</u>

Amount recognized in the consolidated balance sheet at December 31, 2005 and 2004 is as follows:

(Dollars in thousands)	<u>2005</u>	<u>2004</u>
Accrued benefit liability .....	\$ (597)	(525)

The accumulated benefit obligation for health and life insurance plans was \$720,000 and \$646,000 at December 31, 2005 and 2004, respectively.

The components of net periodic postretirement benefit cost for 2005, 2004 and 2003 are as follows:

(Dollars in thousands)	<u>2005</u>	<u>2004</u>	<u>2003</u>
Service cost .....	\$ 43	38	30
Interest cost .....	36	31	30
Amortization of transition obligation .....	15	15	15
Amortization of net gain .....	0	0	(3)
Net periodic postretirement benefit cost .....	<u>\$ 94</u>	<u>84</u>	<u>72</u>

Assumptions used in the measurement of MPB's benefit obligations at December 31, 2005 and 2004 are as follows:

Weighted-average assumptions:	<u>2005</u>	<u>2004</u>
Discount rate .....	5.50%	5.75%
Rate of compensation increase .....	5.00%	5.00%

Assumptions used in the measurement of MPB's net periodic benefit cost for the years ended December 31, 2005, 2004 and 2003 are as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Weighted-average assumptions:			
Discount rate .....	5.75%	6.00%	6.75%
Rate of compensation increase.....	5.00%	5.00%	5.00%

Assumed health care cost trend rates at at December 31, 2005, 2004 and 2003 are as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Health care cost trend rate assumed for next year.....	9.00%	10.00%	5.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) .....	5.00%	5.00%	5.50%
Year that the rate reaches the ultimate trend rate .....	2009	2009	2004

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

(Dollars in thousands)	One-Percentage Point	
	<u>Increase</u>	<u>Decrease</u>
Effect on total of service and interest cost.....	\$ 13	11
Effect on postretirement benefit obligation.....	92	78

MPB expects to contribute \$20,526 to its postretirement benefit plans in 2006.

Estimated Future Benefit Payments

1/1/2006 to 12/31/2006 .....	\$ 20,526
1/1/2007 to 12/31/2007 .....	21,769
1/1/2008 to 12/31/2008 .....	21,188
1/1/2009 to 12/31/2009 .....	29,043
1/1/2010 to 12/31/2010 .....	33,120
1/1/2011 to 12/31/2015 .....	223,626

The following tables provide a reconciliation of the changes in the directors' defined benefit plan's benefit obligations and fair value of plan assets for the years ended December 31, 2005 and 2004 and a statement of the funded status at December 31, 2005 and 2004:

(Dollars in thousands)	December 31,	
	<u>2005</u>	<u>2004</u>
Change in benefit obligations:		
Benefit obligations, January 1.....	\$ 712	647
Service cost .....	26	22
Interest cost.....	41	39
Actuarial (gain) loss.....	17	5
Change in assumptions .....	(57)	17
Benefit payments .....	(23)	(18)
Benefit obligations, December 31 .....	<u>\$ 716</u>	<u>712</u>

(Dollars in thousands)		
	<u>2005</u>	<u>2004</u>
Change in fair value of plan assets:		
Fair value of plan assets, January 1.....	\$ 0	0
Employer contributions.....	23	18
Benefit payments .....	(23)	(18)
Fair value of plan assets, December 31 .....	<u>\$ 0</u>	<u>0</u>

(Dollars in thousands)

	December 31,	
Funded status:		
Excess of the benefit obligation over the value of plan assets.....	\$ (716)	(712)
Unrecognized prior-service cost.....	0	26
Unrecognized loss.....	17	57
Net amount recognized.....	<u>\$ (699)</u>	<u>(629)</u>

Amounts recognized in the consolidated balance sheet at December 31, 2005 and 2004 are as follows:

	2005	2004
(Dollars in thousands)		
Accrued benefit liability.....	\$ (716)	(645)
Intangible asset.....	17	16
Net amount recognized.....	<u>\$ (699)</u>	<u>(629)</u>

The accumulated benefit obligation for the retirement plan was \$716,000 and \$645,000 at December 31, 2005 and 2004, respectively.

Other plan information at December 31, 2005 and 2004 is as follows:

	2005	2004
(Dollars in thousands)		
Projected benefit obligation.....	\$ 716	712
Accumulated benefit obligation.....	716	645
Fair value of plan assets.....	0	0

The components of net periodic pension cost for 2005, 2004 and 2003 are as follows:

	2005	2004	2003
(Dollars in thousands)			
Service cost.....	\$ 26	22	20
Interest cost.....	41	39	37
Amortization of prior-service cost.....	26	26	26
Net periodic pension cost.....	<u>\$ 93</u>	<u>87</u>	<u>83</u>

Assumptions used in the measurement of MPB's benefit obligations at December 31, 2005 and 2004 are as follows:

	2005	2004
Weighted-average assumptions:		
Discount rate.....	5.50%	5.75%
Change in consumer price index.....	3.00%	4.00%

Assumptions used in the measurement of MPB's net periodic benefit cost for the years ended December 31, 2005, 2004 and 2003 are as follows:

	2005	2004	2003
Weighted-average assumptions:			
Discount rate.....	5.75%	6.00%	6.75%
Rate of compensation increase.....	3.00%	4.00%	4.00%

MPB expects to contribute \$50,153 to its pension plan in 2006.

The Bank is the owner and beneficiary of insurance policies on the lives of certain officers and directors which informally fund the retirement plan obligation. The aggregate cash surrender value of these policies was \$2,326,000 and \$2,244,000 at December 31, 2005 and 2004, respectively.

#### Estimated Future Benefit Payments

1/1/2006 to 12/31/2006.....	\$ 50,153
1/1/2007 to 12/31/2007.....	55,350
1/1/2008 to 12/31/2008.....	61,455
1/1/2009 to 12/31/2009.....	60,758
1/1/2010 to 12/31/2010.....	59,835
1/1/2011 to 12/31/2015.....	323,063



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

The Bank has a funded contributory profit-sharing plan covering substantially all employees. The Bank's contribution to the plan was \$277,000 for 2005, \$307,000 for 2004 and \$267,000 for 2003.

**(b) Deferred Compensation Plans**

The Bank has an executive deferred compensation plan which allows an executive officer to defer bonus compensation for a specified period in order to provide future retirement income. At December 31, 2005 and 2004, the Bank has accrued a liability of approximately \$140,000 and \$106,000, respectively, for this plan.

The Bank also has a directors' deferred compensation plan which allows directors to defer receipt of monthly fees for a specified period in order to provide future retirement income. At December 31, 2005 and 2004, the Bank has accrued a liability of approximately \$237,000 and \$179,000, respectively, for this plan.

The Bank is the owner and beneficiary of insurance policies on the lives of the participating executive officer and directors which informally fund the benefit obligations. The aggregate cash surrender value of these policies was approximately \$1,683,000 and \$1,626,000 at December 31, 2005 and 2004, respectively.

**(c) Salary Continuation Agreement**

The Bank maintains a Salary Continuation Agreement (Agreement) for an executive officer. The Agreement provides the executive officer with a fixed annual benefit. The benefit is payable beginning at age 65 for a period of 15 years. If the executive officer terminates employment before the normal retirement date for reasons other than death, the annual benefit payable will be based on the vesting schedule as defined in the Agreement. Upon death or a change in control of the Bank, the executive officer or his beneficiary is entitled to the full fixed annual benefits. At December 31, 2005 and 2004, the Bank has accrued a liability of approximately \$195,000 and \$161,000, respectively, for the Agreement. The expense related to the Agreement was \$34,000 for 2005, \$32,000 for 2004 and \$30,000 for 2003.

The Bank is the owner and beneficiary of an insurance policy on the life of the participating executive officer which informally funds the benefit obligation. The aggregate cash surrender value of this policy was approximately \$897,000 and \$866,000 at December 31, 2005 and 2004, respectively.

**(d) Employee Stock Ownership Plan**

MPB has an Employee Stock Ownership Plan (ESOP) covering substantially all employees. Contributions to the ESOP are made at the discretion of the Board of Directors. Total expense related to MPB's contribution to the ESOP for 2005, 2004 and 2003 was \$139,000, \$155,000 and \$134,000, respectively. The ESOP held 36,160 and 32,836 shares of MPB stock as of December 31, 2005 and December 31, 2004, respectively, all of which were allocated to plan participants. Shares held by the ESOP are considered outstanding for purposes of calculating earnings per share. Dividends paid on shares held by the ESOP are charged to retained earnings.

**(e) Other**

At December 31, 2005 and 2004, the Bank had Split Dollar Life Insurance arrangements with two executives for which the aggregate collateral assignment and cash surrender values are approximately \$1,496,000 and \$1,444,000, respectively.

**(15) Federal Income Taxes**

The following temporary differences gave rise to the net deferred tax asset at December 31, 2005 and 2004:

(Dollars in thousands)	2005	2004
Deferred tax assets:		
Allowance for loan losses .....	\$ 1,106	1,085
Benefit plans .....	669	555
Nonaccrual interest .....	78	54
Core deposit intangible .....	8	3
Total	<u>1,861</u>	<u>1,697</u>
Deferred tax liabilities:		
Depreciation .....	(162)	(198)
Loan fees .....	(138)	(129)
Bond accretion .....	(27)	(20)
Other items .....	(22)	(11)
Unrealized gain on securities .....	(120)	(357)
Total	<u>(469)</u>	<u>(715)</u>
Deferred tax asset, net .....	\$ <u>1,392</u>	<u>982</u>

The provision for income taxes consists of the following:

(Dollars in thousands)	2005	2004	2003
Currently payable .....	\$ 1,773	1,712	1,130
Deferred .....	(173)	(307)	123
Total provision for income taxes .....	\$ <u>1,600</u>	<u>1,405</u>	<u>1,253</u>

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

(Dollars in thousands)	2005	2004	2003
Provision at the expected statutory rate .....	\$ 2,109	1,963	1,995
Effect of tax-exempt income .....	(533)	(583)	(752)
Nondeductible interest .....	39	34	53
Other items .....	(15)	(9)	(43)
Provision for income taxes .....	\$ <u>1,600</u>	<u>1,405</u>	<u>1,253</u>

**(16) Business Combination**

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

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

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

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

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

### (17) Core Deposit Intangible

A summary of core deposit intangible is as follows at December 31, 2005.

(Dollars in thousands)	
Gross carrying amount .....	\$ 291
Less accumulated amortization .....	56
Net carrying amount	<u>\$ 235</u>

Amortization expense amounted to \$36,000 in 2005 and \$20,000 in 2004.

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

### (18) Regulatory Matters

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

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

(Dollars in thousands)	<u>Capital Adequacy</u>				To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	<u>Actual:</u>		<u>Minimum Capital Required:</u>		<u>Action Provisions:</u>	
As of December 31, 2005:	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Tier I Capital (to Average Assets) .....	\$ 31,404	7.3%	17,172	4.0%	21,465	5.0%
Tier I Capital (to Risk Weighted Assets) .....	31,404	9.3	13,487	4.0	20,231	6.0
Total Capital (to Risk Weighted Assets) .....	35,108	10.4	26,974	8.0	33,718	10.0
As of December 31, 2004:						
Tier I Capital (to Average Assets) .....	\$ 27,346	7.0%	15,604	4.0%	19,505	5.0%
Tier I Capital (to Risk Weighted Assets) .....	27,346	9.0	12,147	4.0	18,221	6.0
Total Capital (to Risk Weighted Assets) .....	30,989	10.2	24,294	8.0	30,368	10.0

As of December 31, 2005 and 2004, the Bank's capital ratios are in excess of the minimum and well-capitalized guidelines and MPB's capital ratios are in excess of the Bank's capital ratios.

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

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

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

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

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

As of December 31, 2005, commitments to extend credit amounted to \$64,795,000 and financial standby letters of credit amounted to \$10,102,000.

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

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

As of December 31, 2005, commercial real estate financing was the only similar activity that met the requirements to be classified as a significant concentration of credit risk. However, there is a geographical concentration in that most of the Bank's business activity is with customers located in Central Pennsylvania, specifically within the Bank's trading area made up of Dauphin County, lower Northumberland County, western Schuylkill County and Hampden Township in Cumberland County.

The Bank's highest concentrations of credit are in the areas of hotel/motel lodging financings and apartment building financing. Outstanding credit to these sectors amounted to \$27,483,000 or 8.9% and \$25,416,000 or 8.2%, respectively, of net loans outstanding as of December 31, 2005.

(20) Commitments and Contingencies

Operating Lease

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

Minimum future rental payments under this operating lease as of December 31, 2005 for each of the next 5 years and in the aggregate are:

2006 .....	\$	67,608
2007 .....		69,636
2008 .....		71,725
2009 .....		73,877
2010 .....		18,605
	\$	<u>301,451</u>

Litigation

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

**(21) Parent Company Statements**

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

## CONDENSED BALANCE SHEET

December 31, 2005 and 2004

(Dollars in thousands)

	<u>2005</u>	<u>2004</u>
<b>ASSETS</b>		
Cash .....	\$ 273	273
Investment in Subsidiaries.....	36,588	34,999
Total Assets	<u>\$ 36,861</u>	<u>35,272</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Stockholders' Equity .....	\$ 37,397	35,808
Less Treasury Stock .....	(536)	(536)
Total Liabilities and Equity	<u>\$ 36,861</u>	<u>35,272</u>

## CONDENSED STATEMENT OF INCOME

For Years Ended December 31, 2005, 2004 and 2003

(Dollars in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Dividends from Subsidiaries .....	\$ 2,643	5,774	2,566
Other Income from Subsidiaries .....	47	23	24
Undistributed Earnings of Subsidiaries .....	2,051	(1,361)	2,097
Other Expenses .....	(138)	(67)	(72)
Net Income	<u>\$ 4,603</u>	<u>4,369</u>	<u>4,615</u>

## CONDENSED STATEMENT OF CASH FLOWS

For Years Ended December 31, 2005, 2004 and 2003

(Dollars in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net Income .....	\$ 4,603	4,369	4,615
Undistributed Earnings of Subsidiaries .....	(2,051)	1,361	(2,097)
Net Cash Provided By Operating Activities	<u>2,552</u>	<u>5,730</u>	<u>2,518</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Dividends Paid.....	(2,552)	(5,739)	(2,499)
Sale (Purchase) of Treasury Stock .....	0	3	(17)
Net Cash Used In Financing Activities	<u>(2,552)</u>	<u>(5,736)</u>	<u>(2,516)</u>
Net (Decrease) Increase in Cash .....	0	(6)	2
Cash at Beginning of Period .....	273	279	277
Cash at End of Period.....	<u>\$ 273</u>	<u>273</u>	<u>279</u>

**(22) Fair Value of Financial Instruments**

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

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

Cash and due from banks:

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

Interest-bearing balances with other financial institutions:

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

## Investment securities:

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

## Loans:

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

## Deposits:

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

## Short-term borrowings:

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

## Long-term debt:

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

## Accrued interest:

The carrying amounts of accrued interest approximates their fair values.

## Off-balance sheet financial instruments:

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

The following table summarizes the book value and fair value of financial instruments at December 31, 2005 and 2004.

(Dollars in thousands)	December 31, 2005		December 31, 2004	
	Book	Fair	Book	Fair
Financial assets:	<u>Value</u>	<u>Value</u>	<u>Value</u>	<u>Value</u>
Cash and due from banks.....	\$ 6,350	6,350	6,679	6,679
Interest-bearing balances.....	54,549	54,549	60,407	60,407
Investment securities.....	50,878	50,878	44,613	44,613
Net loans.....	308,133	306,157	275,904	283,141
(Dollars in thousands)				
Financial liabilities:	<u>Value</u>	<u>Value</u>	<u>Value</u>	<u>Value</u>
Deposits.....	\$ 325,274	324,461	301,144	302,517
Short-term borrowings.....	12,342	12,342	13,801	13,801
Accrued interest.....	1,535	1,535	1,192	1,192
Long-term debt.....	59,838	59,829	49,957	53,081
Off-balance sheet financial instruments:				
Commitments to extend credit.....	\$ 64,795	64,795	61,028	61,028
Financial standby letters of credit.....	10,102	10,102	11,904	11,904

(23) Common Stock:

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

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

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

The following table presents summarized quarterly financial data for 2005, 2004 and 2003.

(Dollars in Thousands, Except Per Share Data)

		2005 Quarter Ended			
		Mar. 31	June 30	Sept. 30	Dec. 31
Interest Income .....	\$	5,348	5,663	5,982	6,301
Interest Expense .....		<u>2,103</u>	<u>2,284</u>	<u>2,492</u>	<u>2,678</u>
Net Interest Income .....		3,245	3,379	3,490	3,623
Provision for Loan Losses .....		<u>60</u>	<u>110</u>	<u>280</u>	<u>(225)</u>
Net Interest Income After Provision for Loan Losses .....		3,185	3,269	3,210	3,848
Other Income .....		732	686	817	698
Securities Gains .....		0	1	0	0
Gain on Sale of Loans .....		0	0	19	0
Other Expenses .....		<u>2,540</u>	<u>2,621</u>	<u>2,527</u>	<u>2,574</u>
Income Before Income Tax Provision .....		1,377	1,335	1,519	1,972
Income Tax Provision .....		<u>360</u>	<u>333</u>	<u>387</u>	<u>520</u>
Net Income .....	\$	<u>1,017</u>	<u>1,002</u>	<u>1,132</u>	<u>1,452</u>
Earnings Per Share .....	\$	<u>.30</u>	<u>.30</u>	<u>.34</u>	<u>.43</u>

(Dollars in Thousands, Except Per Share Data)

		2004 Quarter Ended			
		Mar. 31	June 30	Sept. 30	Dec. 31
Interest Income .....	\$	4,736	4,929	5,177	5,235
Interest Expense .....		<u>1,927</u>	<u>1,885</u>	<u>2,021</u>	<u>2,172</u>
Net Interest Income .....		2,809	3,044	3,156	3,063
Provision for Loan Losses .....		<u>0</u>	<u>425</u>	<u>200</u>	<u>100</u>
Net Interest Income After Provision for Loan Losses .....		2,809	2,619	2,956	2,963
Other Income .....		681	688	742	871
Securities Gains .....		202	234	39	0
Gain on Sale of Loans .....		0	0	0	0
Other Expenses .....		<u>2,277</u>	<u>2,251</u>	<u>2,331</u>	<u>2,171</u>
Income Before Income Tax Provision .....		1,415	1,290	1,406	1,663
Income Tax Provision .....		<u>329</u>	<u>317</u>	<u>349</u>	<u>410</u>
Net Income .....	\$	<u>1,086</u>	<u>973</u>	<u>1,057</u>	<u>1,253</u>
Earnings Per Share .....	\$	<u>0.32</u>	<u>0.29</u>	<u>0.31</u>	<u>0.38</u>

(Dollars in Thousands, Except Per Share Data)

		2003 Quarter Ended			
		Mar. 31	June 30	Sept. 30	Dec. 31
Interest Income .....	\$	5,139	5,089	4,902	4,854
Interest Expense .....		<u>2,281</u>	<u>2,108</u>	<u>2,034</u>	<u>2,011</u>
Net Interest Income .....		2,858	2,981	2,868	2,843
Provision for Loan Losses .....		<u>190</u>	<u>25</u>	<u>75</u>	<u>0</u>
Net Interest Income After Provision for Loan Losses .....		2,668	2,956	2,793	2,843
Other Income .....		598	570	585	648
Securities Gains .....		0	170	88	3
Gain on Sale of Loans .....		0	0	0	45
Other Expenses .....		<u>1,948</u>	<u>2,025</u>	<u>2,077</u>	<u>2,049</u>
Income Before Income Tax Provision .....		1,318	1,671	1,389	1,490
Income Tax Provision .....		<u>266</u>	<u>404</u>	<u>303</u>	<u>280</u>
Net Income .....	\$	<u>1,052</u>	<u>1,267</u>	<u>1,086</u>	<u>1,210</u>
Earnings Per Share .....	\$	<u>0.31</u>	<u>0.38</u>	<u>0.32</u>	<u>0.37</u>

**(25) Subsequent Event**Stock Dividend

On January 27, 2006, the Board of Directors declared a 5% stock dividend payable on February 27, 2006 to stockholders of record on February 8, 2006. Per-share amounts in the accompanying financial statements have been restated for all periods presented to reflect the effect of this stock dividend.

**(26) Recent Accounting Pronouncements:**

In November 2005, the FASB issued Staff Position (FSP) Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. This FSP addresses the determination of when an investment is considered to be impaired, whether the impairment is other-than-temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary. The guidance in this FSP must be applied to all reporting periods beginning after December 15, 2005; however, MPB expects no material impact from this FSP.

In December 2004, the FASB issued SFAS No. 123R that replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, and supercedes APB Opinion 25, *Accounting for Stock Issued to Employees*. SFAS No. 123R requires that the cost of share-based payment transactions (including those with employees and nonemployees) be recognized in the financial statements. SFAS No. 123R applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share options, or other equity instruments (except for those held by an ESOP) or by incurring liabilities (1) in amounts based (even in part) on the price of the entity's shares or other equity instruments, or (2) that require (or may require) settlement by the issuance of an entity's shares or other equity instruments. MPB will implement this new standard in the first quarter of 2006 but, since MPB has no share-based payments, it will have no impact on the financial statements.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* that changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 replaces APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement also redefines "restatement" to include the revision of previously issued financial statements to reflect the correction of an error. This statement is effective for accounting changes and error corrections made in fiscal years beginning after December 15, 2005.



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

### Financial Summary

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

MPB earned net income of \$4,603,000 for the year 2005, compared to \$4,369,000 in 2004, which was an increase of \$234,000 or 5.4%. This represents net income in 2005 of \$1.37 per share compared to \$1.30 per share in 2004 and \$1.38 per share in 2003. The major reason for the decrease in earnings in 2004 was the large provision for possible loan and lease losses of \$725,000, compared to \$225,000 in 2005 and \$290,000 in 2003. The larger provision was needed because of the strong growth in the loan portfolio as well as the reclassification of a \$3.5 million loan as substandard. The improved status of the same loan relationship in 2005 allowed the Bank to reduce its 2005 provision to \$225,000.

Total assets of MPB continued to grow in 2005, reaching the level of \$438,110,000, an increase of \$34,854,000 or 8.6% over \$403,256,000 at year end 2004. The majority of growth came from increases in commercial real estate loans in the Capital Region. These increases were funded primarily through growth in deposits, along with increased long-term borrowings.

MPB continued to achieve a solid return on average shareholders' equity, (ROE), a widely recognized performance indicator in the financial industry. The ROE was 12.87% in 2005, 12.73% in 2004 and 12.69% in 2003. Return on average assets (ROA), another performance indicator, was 1.10% in 2005, 1.12% in 2004 and 1.25% in 2003.

Tier one capital (to risk weighted assets) of \$31,404,000 or 9.3% and total capital (to risk weighted assets) of \$35,108,000 or 10.4% at December 31, 2005, are above the regulatory requirement, which is 4% for tier one capital and 8% for total capital. Tier one capital consists primarily of the bank's stockholders' equity. Total capital includes qualifying subordinated debt, if any, and the allowance for loan and lease losses, within permitted limits. Risk-weighted assets are determined by assigning various levels of risk to different categories of assets and off-balance sheet activities.

### Critical Accounting Policies

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

### Net Interest Income

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

During 2005 net interest income increased \$1,665,000 or 13.8% as compared to an increase of \$522,000 or 4.5% in 2004. The average balances, effective interest differential and interest yields for the years ended December 31, 2005, 2004 and 2003 and the components of net interest income, are presented in Table 1. A comparative presentation of the changes in net interest income for 2005 compared to 2004, and 2004 compared to 2003, is given in Table 2. This analysis indicates the changes in interest income and interest expense caused by the volume and rate components of interest earning assets and interest bearing liabilities.

The yield on earning assets increased to 6.10% in 2005 from 5.66% in 2004. The yield on earning assets for 2003 was 6.08%. The change in the yield on earning assets was due primarily to the upward movement of rates on new and maturing assets. The average "prime rate" for 2005 was 6.19% as compared to 4.34% for 2004 and 4.12% for 2003.

Interest expense increased by \$1,552,000 or 19.39% in 2005 as compared to a decrease of \$429,000 or 5.09% in 2004. In order to maintain the spread between interest earning assets and interest bearing liabilities, management was forced to aggressively decrease the expense on deposits during 2003 and the first half of 2004.

Primarily resulting from the fluctuations in interest rates, the net interest margin, on a tax equivalent basis, in 2005 was 3.67% compared to 3.48% in 2004 and 3.63% in 2003. Management continues to closely monitor the net interest margin.

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

INCOME AND RATES ON A TAXABLE EQUIVALENT BASIS  
FOR YEAR ENDED DECEMBER 31, 2005

(Dollars in thousands)	Average Balance	Interest Income/Expense	Average Rates Earned/Paid
<b>ASSETS:</b>			
Interest Bearing Balances .....	\$ 58,735	2,067	3.52%
Investment Securities:			
Taxable .....	23,081	893	3.87%
Tax-Exempt .....	22,866	1,561	6.83%
Total Investment Securities	45,947		
Federal Funds Sold .....	1,623	53	3.27%
Loans, Net .....	287,185	19,427	6.76%
Total Earning Assets .....	393,490	24,001	6.10%
Cash and Due from Banks .....	6,940		
Other Assets .....	18,218		
Total Assets	\$ 418,648		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY:</b>			
Interest Bearing Deposits:			
NOW .....	\$ 32,507	58	0.18%
Money Market .....	50,913	1,073	2.11%
Savings .....	28,179	69	0.24%
Time .....	158,935	5,321	3.35%
Short-term Borrowings .....	7,498	203	2.71%
Long-term Debt .....	59,021	2,833	4.80%
Total Interest Bearing Liabilities .....	337,053	9,557	2.84%
Demand Deposits .....	41,484		
Other Liabilities .....	4,332		
Stockholders' Equity .....	35,779		
Total Liabilities and Stockholders' Equity	\$ 418,648		
Net Interest Income .....	\$	14,444	
Net Yield on Interest Earning Assets:			
Total Yield on Earning Assets .....			6.10%
Rate on Supporting Liabilities .....			2.43%
Net Interest Margin .....			3.67%
Average Interest Spread .....			3.26%

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

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

(Dollars in thousands)

	Average Balance	Interest Income/Expense	Average Rates Earned/Paid
<b>ASSETS:</b>			
Interest Bearing Balances .....	\$ 66,750	1,809	2.71%
Investment Securities:			
Taxable .....	17,531	599	3.42%
Tax-Exempt .....	<u>26,555</u>	1,948	7.34%
Total Investment Securities	<u>44,086</u>		
Federal Funds Sold .....	346	7	2.02%
Loans, Net .....	<u>256,627</u>	<u>16,449</u>	6.41%
Total Earning Assets .....	<u>367,809</u>	<u>20,812</u>	5.66%
Cash and Due from Banks .....	6,527		
Other Assets .....	<u>16,002</u>		
Total Assets	\$ <u>390,338</u>		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY:</b>			
Interest Bearing Deposits:			
NOW .....	\$ 34,750	61	0.18%
Money Market .....	45,202	442	0.98%
Savings .....	29,027	77	0.27%
Time .....	153,100	5,044	3.29%
Short-term Borrowings .....	11,415	137	1.20%
Long-term Debt .....	<u>43,780</u>	<u>2,244</u>	5.13%
Total Interest Bearing Liabilities .....	<u>317,274</u>	<u>8,005</u>	2.52%
Demand Deposits .....	37,586		
Other Liabilities .....	1,951		
Stockholders' Equity .....	<u>33,527</u>		
Total Liabilities and Stockholders' Equity	\$ <u>390,338</u>		
Net Interest Income .....	\$	<u>12,807</u>	
Net Yield on Interest Earning Assets:			
Total Yield on Earning Assets .....			5.66%
Rate on Supporting Liabilities .....			2.18%
Net Interest Margin .....			3.48%
Average Interest Spread .....			3.14%

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

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

(Dollars in thousands)

	Average Balance	Interest Income/Expense	Average Rates Earned/Paid
<b>ASSETS:</b>			
Interest Bearing Balances .....	\$ 68,256	2,099	3.08%
Investment Securities:			
Taxable .....	14,222	559	3.93%
Tax-Exempt .....	36,355	2,702	7.43%
Total Investment Securities	<u>50,577</u>		
Federal Funds Sold.....	950	9	0.95%
Loans, Net.....	224,993	15,598	6.93%
Total Earning Assets.....	344,776	<u>20,967</u>	6.08%
Cash and Due from Banks.....	6,306		
Other Assets.....	17,489		
Total Assets	\$ <u>368,571</u>		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY:</b>			
Interest Bearing Deposits:			
NOW .....	\$ 33,897	82	0.24%
Money Market .....	45,072	638	1.42%
Savings .....	27,756	165	0.59%
Time .....	144,194	5,232	3.63%
Short-term Borrowings.....	10,670	128	1.20%
Long-term Debt .....	36,463	2,189	6.00%
Total Interest Bearing Liabilities .....	298,052	<u>8,434</u>	2.83%
Demand Deposits.....	30,918		
Other Liabilities .....	4,309		
Stockholders' Equity .....	<u>35,292</u>		
Total Liabilities and Stockholders' Equity	\$ <u>368,571</u>		
Net Interest Income .....	\$	<u>12,533</u>	
Net Yield on Interest Earning Assets:			
Total Yield on Earning Assets.....			6.08%
Rate on Supporting Liabilities.....			2.45%
Net Interest Margin.....			3.63%
Average Interest Spread .....			3.25%

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

Loan fees of \$492,000, \$448,000 and \$612,000 are included with interest income in Table 1 for the years 2005, 2004 and 2003, respectively.

TABLE 2: VOLUME ANALYSIS OF CHANGES IN NET INTEREST INCOME

(Dollars in thousands)

	2005 Compared to 2004			2004 Compared to 2003		
	Increase (Decrease) Due to Change In:			Increase (Decrease) Due to Change In:		
<i>Taxable Equivalent Basis</i>	Volume	Rate	Net	Volume	Rate	Net
<b>INTEREST INCOME:</b>						
Interest Bearing Balances .....	\$ (217)	475	258	(46)	(244)	(290)
Investment Securities:						
Taxable .....	190	104	294	130	(90)	40
Tax-Exempt .....	(271)	(116)	(387)	(719)	(35)	(754)
Total Investment Securities	(81)	(12)	(93)	(635)	(369)	(714)
Federal Funds Sold .....	26	20	46	(6)	4	(2)
Loans, Net .....	1,959	1,019	2,978	2,192	(1,341)	851
Total Interest Income	1,687	1,502	3,189	1,551	(1,706)	(155)
<b>INTEREST EXPENSE:</b>						
Interest Bearing Deposits:						
NOW .....	(3)	0	(3)	2	(23)	(21)
Money Market .....	56	575	631	2	(198)	(196)
Savings .....	(2)	(6)	(8)	7	(95)	(88)
Time .....	192	85	277	323	(511)	(188)
Total Interest Bearing Deposits	243	654	897	334	(827)	(493)
Short-term Borrowings .....	(47)	113	66	9	0	9
Long-term Debt .....	782	(193)	589	439	(384)	55
Total Interest Expense	978	574	1,552	782	(1,211)	(429)
<b>NET INTEREST INCOME .....</b>	<b>\$ 709</b>	<b>928</b>	<b>1,637</b>	<b>769</b>	<b>(495)</b>	<b>274</b>

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

### Provision for Loan and Lease Losses

The provision for loan and lease losses charged to operating expense represents the amount deemed appropriate by management to maintain an adequate allowance for possible loan and lease losses. Following its model for loan and lease loss allowance adequacy, management made a \$225,000 provision in 2005 as well as a provision of \$725,000 in 2004 and \$290,000 in 2003. The allowance for loan and lease losses as a percentage of total loans was 1.18% at December 31, 2005, compared to 1.30% at December 31, 2004 and 1.28% at December 31, 2003, which continues to be higher than that of peer financial institutions due to MPB's higher level of loans to finance commercial real estate. The higher 2004 provision was due to a more than 20% growth in loans during the year and the reclassification of a large commercial loan relationship to a substandard classification by the Bank's regulators. The improved status of the same loan relationship in the fourth quarter of 2005 allowed the Bank to reduce its December 31, 2005 allowance for loan and lease loss, accounting for much of the decrease in the provision for loan and lease losses in 2005. A summary of charge-offs and recoveries of loans and leases is presented in Table 3.

TABLE 3: ANALYSIS OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES

(Dollars in thousands)

	Years ended December 31,				
	2005	2004	2003	2002	2001
Balance, beginning of year.....	\$ 3,643	2,992	3,051	2,856	2,815
Loans charged-off:					
Commercial real estate, construction and land development.....	32	25	171	41	249
Commercial, industrial and agricultural.....	29	10	140	113	118
Real estate-residential.....	0	8	0	0	0
Consumer.....	138	78	98	148	122
Total loans charged off	199	121	409	302	489
Recoveries on loans previously charged-off:					
Commercial real estate, construction and land development.....	0	0	0	17	0
Commercial, industrial and agricultural.....	12	8	14	0	1
Real estate-residential.....	0	0	0	0	0
Consumer.....	23	39	46	55	29
Total recoveries	35	47	60	72	30
Net charge-offs.....	164	74	349	230	459
Provision for loan and lease losses.....	225	725	290	425	500
Balance, end of year.....	\$ 3,704	3,643	2,992	3,051	2,856
Ratio of net charge-offs during the year to average loans outstanding during the year, net of unearned discount.....	.06%	.03%	.14%	.11%	.24%
Allowance for loan losses as a percentage of total loans.....	1.18%	1.30%	1.28%	1.37%	1.39%

Noninterest Income

During 2005, MPB earned \$2,953,000 in noninterest income, compared to \$3,457,000 earned in 2004 and \$2,707,000 earned in 2003.

Service charges on deposit accounts amounted to \$1,348,000 for 2005, a decrease of \$119,000 or 8.1% compared to \$1,467,000 for 2004, an increase of \$240,000 or 19.6% over 2003. The majority of this decrease is attributed to reduced revenues from NSF charges, which was a result of the closure and sale of deposits of the Tremont office in early 2005 due to the expiration of a lease agreement on the office space.

Gains on the sale of investment securities amounted to \$475,000 in 2004 as MPB realized certain investment gains in anticipation of rising rates and diminishing gains. The same opportunities for security gains, which would not compromise future earnings, did not present themselves in 2005.

MPB owns cash surrender value life insurance policies that provide funding for director retirement and salary continuation plans. The income on these policies amounted to \$222,000 during the year 2005, \$211,000 in 2004 and \$210,000 in 2003.

Trust department income for 2005 was \$312,000, a \$64,000 or 25.8% increase from the \$248,000 in 2004, which was a \$46,000 or 22.8% increase from the \$202,000 earned in 2003. Trust Department income can fluctuate from year to year, due to the number of estates being settled during the year.

MPB also earned \$70,000 in 2005, \$162,000 in 2004 and \$21,000 in 2003 in fees from the third-party provider of investments whose services the Bank has contracted. The decrease in investment services income resulted from a vacancy in the investment representative position for more than six months during 2005. Other income amounted to \$758,000 in 2005, \$725,000 in 2004 and \$592,000 in 2003, including gains on other real estate. The increase in other noninterest income is due to the aggregate of several relatively small increases in other fee areas throughout the bank, as management continues to focus on generating noninterest income.

### Noninterest Expense

A summary of the major components of noninterest expense for the years ended December 31, 2005, 2004 and 2003 is reflected in Table 4. Noninterest expense increased to \$10,262,000 in 2005 from \$9,030,000 in 2004 and \$9,030,000 in 2003. The major component of noninterest expense is salaries and employee benefits. The number of full-time equivalent employees increased from 116 to 124 during 2005. Increases in the 2005 workforce included the management and staffing for two new offices in the Capital Region. These new offices were the driving factor behind much of the increased expense in 2005. In addition to the personnel costs, there were associated increases in occupancy, equipment and marketing. Another significant expense in 2005 was the cost of complying with Section 404 of the Sarbanes-Oxley Act. The annual cost of compliance is approaching \$200,000 in higher audit costs and additional personnel expense.

**TABLE 4: NONINTEREST EXPENSE**

(Dollars in thousands)

	Years ended December 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Salaries and employee benefits .....	\$ 5,662	4,918	4,496
Occupancy, net .....	594	456	423
Equipment .....	734	631	602
Postage and supplies .....	370	308	320
Marketing and advertising .....	298	185	100
Other real estate, net .....	91	0	135
Pennsylvania bank shares tax .....	259	265	266
External audit and tax preparation .....	132	72	64
Telephone .....	91	86	77
Loss on mortgage sales .....	51	66	146
Legal and professional services .....	408	385	284
Debit card processing .....	154	214	167
Director fees and benefits .....	221	196	201
Computer software licensing and maintenance .....	179	170	91
Other .....	1,018	1,078	727
Total Noninterest Expense	<u>\$ 10,262</u>	<u>9,030</u>	<u>8,099</u>

### Investments

MPB's investment portfolio is utilized to provide liquidity and managed to maximize return within reasonable risk parameters.

MPB's entire portfolio of investment securities is considered available for sale. As such, the investments are recorded at fair value. Our investments: US Treasury, Agency and Municipal securities are valued at a market price relative to investments of the same type with similar maturity dates. As the interest rate environment of these securities changes, the value of securities changes accordingly.

As of December 31, 2005, SFAS No. 115 resulted in a contribution to shareholders' equity of \$231,000 (unrealized gain on securities of \$352,000 less estimated income tax expense of \$121,000). At December 31, 2004, SFAS No. 115 resulted in an increase of shareholders' equity of \$693,000 (unrealized gain on securities of \$1,051,000 less estimated income tax expense of \$357,000) compared to a December 31, 2003 increase in shareholders' equity of \$1,415,000 (unrealized gain on securities of \$2,144,000, less estimated income tax expense of \$729,000).

MPB does not have any significant concentrations of investment securities.

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

TABLE 5: AMORTIZED COST OF INVESTMENT SECURITIES

	December 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
(Dollars in thousands)			
U. S. Treasury and U.S. government agencies .....	\$ 14,999	11,998	10,564
Mortgage-backed U.S. government agencies.....	8,112	5,508	4,808
State and political subdivision obligations .....	24,162	22,621	34,447
Restricted equity securities.....	3,253	3,435	2,130
Total	<u>\$ 50,526</u>	<u>43,561</u>	<u>51,949</u>

### Loans

At December 31, 2005, net loans totaled \$308,133,000, a \$32,229,000 or 11.7% increase from December 31, 2004. During 2005, MPB experienced a net increase in commercial real estate and commercial/industrial loans of approximately \$24,264,000, the majority of which was generated in the greater Capital (Harrisburg) Region.

The current environment in lending remains extremely competitive with financial institutions aggressively pursuing potential borrowers. At December 31, 2005, loans, net of unearned income, represented 73.7% of earning assets as compared to 71.5% on December 31, 2004 and 64.3% on December 31, 2003.

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

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

TABLE 6: LOAN PORTFOLIO

	December 31,									
	<u>2005</u>		<u>2004</u>		<u>2003</u>		<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>Percent of Loans</u>	<u>Amount</u>	<u>Percent of Loans</u>	<u>Amount</u>	<u>Percent of Loans</u>	<u>Amount</u>	<u>Percent of Loans</u>	<u>Amount</u>	<u>Percent of Loans</u>
Commercial real estate, construction and land development.....	\$ 219,385	70.0%	195,549	69.6%	154,296	66.5%	146,325	65.6%	130,983	63.8%
Commercial, industrial and agricultural.....	31,368	10.0	30,940	11.0	25,567	11.0	22,398	10.0	23,107	11.3
Real estate-residential .....	44,688	14.3	43,914	15.6	43,384	18.7	41,502	18.6	38,349	18.7
Consumer .....	<u>17,982</u>	5.7	<u>10,680</u>	3.8	<u>10,380</u>	3.8	<u>12,978</u>	5.8	<u>12,732</u>	6.2
Total Loans	313,423	100	281,083	100	233,627	100	233,203	100	205,101	100
Unearned income.....	<u>(1,586)</u>		<u>(1,536)</u>		<u>(1,549)</u>		<u>(1,850)</u>		<u>(2,265)</u>	
Loans net of unearned discount.....	311,837		279,547		232,078		221,353		202,836	
Allowance for loan and lease losses.....	<u>(3,704)</u>		<u>(3,643)</u>		<u>(2,992)</u>		<u>(3,051)</u>		<u>(2,856)</u>	
Net Loans	<u>\$ 308,133</u>		<u>275,904</u>		<u>229,086</u>		<u>218,302</u>		<u>99,980</u>	



### Allowance for Loan and Lease Losses

The allowance for loan and lease losses is maintained at a level believed adequate by Management to absorb potential losses in the loan and lease portfolio. MPB has a loan review department that is charged with establishing a "watch list" of potential unsound loans, identifying unsound credit practices and suggesting corrective actions. A quarterly review and reporting process is in place for monitoring those loans that are on the "watch list." Each credit on the "watch list" is evaluated to estimate potential losses. In addition, loss estimates for each category of credit are provided based on Management's judgment which considers past experience, current economic conditions and other factors. For installment, real estate mortgages and other consumer loans, specific reserve allocations are based on past loss experience adjusted for recent portfolio growth and economic trends.

Calculated amounts resulting from this analysis are "specific" allocations. The amounts not specifically provided for individual classes of loans are considered "general." The general portion of the allowance is determined and based on judgments regarding economic conditions, trends and other factors.

The 2005 provision of \$225,000 is comparable to the provisions recorded in prior years with the exception of 2004. During 2004, the provision increased to \$725,000. The majority of the 2004 increase was caused by potential issues related to the status of a large commercial loan relationship.

The allocation of the allowance for loan and lease losses among the major classifications is shown in Table 7 as of December 31 of each of the past five years. The allowance for loan and lease losses at December 31, 2005 was \$3,704,000 or 1.19% of total loans less unearned discount as compared to \$3,643,000 or 1.30% at December 31, 2004, and \$2,992,000 or 1.29% at December 31, 2003. Despite higher non-performing assets (see Table 8), reserve ratios at December 31, 2005 were considered adequate based on management's quarterly review analysis.

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

(Dollars in thousands)	December 31,				
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Commercial real estate, construction and land development .....	\$ 2,037	2,368	1,938	1,898	1,584
Commercial, industrial and agricultural .....	1,481	1,093	954	922	987
Real estate-residential .....	52	65	20	56	73
Consumer .....	110	83	65	147	166
General .....	24	34	15	28	46
Total Loans	<u>\$ 3,704</u>	<u>3,643</u>	<u>2,992</u>	<u>3,051</u>	<u>2,856</u>

### Nonperforming Assets

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

Consumer loans are generally recommended for charge-off when they become 120 days delinquent. All 1-4 family residential mortgages 90 days or more past due are reviewed quarterly by Management, and collection decisions are made in light of the analysis of each individual loan. The amount of consumer and residential mortgage loans past due 90 days or more at year-end was \$892,000, \$397,000 and \$533,000 in 2005, 2004 and 2003, respectively.

A presentation of nonperforming assets as of December 31, for each of the past five years is given in Table 8. Nonperforming assets at December 31, 2005, totaled \$3,317,000 or 0.76% of total assets compared to \$1,775,000 or 0.44% of total assets in 2004, and \$2,767,000 or 0.74% of total assets in 2003. The foreclosed assets held for sale at December 31, 2005, consist of two parcels of commercial real estate and one residential property.

TABLE 8: NONPERFORMING ASSETS

(Dollars in thousands)	December 31,				
	2005	2004	2003	2002	2001
Nonaccrual loans.....	\$ 1,773	873	984	1,164	1,686
Past due 90 days or more .....	1,086	397	666	808	828
Restructured loans.....	0	0	0	0	537
Total nonperforming loans	2,859	1,270	1,650	1,972	3,051
Foreclosed assets held for sale .....	458	505	1,117	781	1,693
Total nonperforming assets	\$ 3,317	1,775	2,767	2,753	4,744
Percent of loans outstanding.....	1.06%	0.63%	1.18%	1.23%	2.31%
Percent of total assets.....	0.76%	0.44%	0.74%	0.76%	1.44%

There are no trends or uncertainties which Management expects will materially impact future operating results, liquidity or capital resources. There are no material credits about which Management has any information to cause serious doubts as to the ability of such borrowers to comply with loan repayment terms.

### Deposits and Other Funding Sources

MPB's primary source of funds is its deposits. Deposits at December 31, 2005, increased by \$24,130,000 or 8.0% over December 31, 2004, which also increased by \$12,806,000 or 4.4% from December 31, 2003. Average balances and average interest rates applicable to the major classifications of deposits for the years ended December 31, 2005, 2004, and 2003 are presented in Table 9. The majority of 2005 deposit growth was related to the opening of two new offices in Harrisburg, PA.

Average short-term borrowings for 2005 were \$7,498,000 as compared to \$11,415,000 in 2004. These borrowings included customer repurchase agreements, treasury tax and loan option borrowings and federal funds purchased. A ten million dollar borrowing, maturing in February of 2008 was entered into during 2005 with the FHLB.

TABLE 9: DEPOSITS BY MAJOR CLASSIFICATION

(Dollars in thousands)	Years ended December 31,					
	2005		2004		2003	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing demand deposits.....	\$ 41,484	0.00%	38,884	0.00%	30,918	0.00%
Interest-bearing demand deposits .....	32,507	0.18%	34,750	0.18%	33,897	0.24%
Money market.....	50,913	2.11%	45,202	0.98%	45,072	1.42%
Savings.....	28,179	0.24%	29,027	0.27%	27,756	0.59%
Time .....	158,935	3.35%	153,100	3.29%	144,194	3.63%
Total \$	312,018	2.09%	300,963	1.88%	281,837	2.17%

### Capital Resources

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

Stockholders' equity increased in 2005 by \$1,589,000 or 4.5%. In 2004, capital decreased by \$2,089,000 or 5.6%, largely due to the \$1 per share special dividend in the first quarter of 2004. In 2003, capital was increased by \$2,157,000 or 6.1%. Capital growth is achieved by retaining more in earnings than is paid out to our shareholders.

MPB's normal dividend payout allows for quarterly cash returns to its stockholders and provides earnings retention at a level sufficient to finance future growth. The dividend payout ratio, which represents the percentage of annual net income returned to the stockholders in the form of cash dividends, was 56% for 2005 compared to 131% for 2004 and 54% for 2003.

At December 31, 2005, 19,056 shares of MPB's common stock have been purchased back by MPB, held as treasury stock, and are available for issuance under the dividend reinvestment plan or the stock bonus plan. The treasury stock may also be used for the employee stock ownership plan.

### Federal Income Taxes

Federal income tax expense for 2005 was \$1,600,000 compared to \$1,405,000 and \$1,253,000 in 2004 and 2003, respectively. The effective tax rate was 26% for 2005, 24% for 2004 and 21% for 2003. The reason for the increase in effective rate was a lower mix of tax-exempt earning assets.

### Liquidity

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

The major sources of cash in 2005 came from operations and a net increase in deposits of \$24,130,000, particularly in the money market demand deposit category as a premium rate special was offered at the two new offices. Other major sources of funds included a \$10,000,000 borrowing from the Federal Home Loan Bank, and a net decrease of interest-bearing balances, jumbo certificates of deposit, of \$5,858,000.

Major uses of funds in 2005, included a net increase of loans of \$32,783,000 as well as a net increase of investment securities of \$6,265,000.

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

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

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

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

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

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

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

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

TABLE 10: INVESTMENT MATURITY AND YIELD

(Dollars in thousands)

	December 31, 2005				
	One Year and Less	After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	Total
U.S. Treasury and U.S. government agencies .....	\$ 0	8,999	3,500	2,500	14,999
State and political subdivision obligations .....	220	2,918	11,522	9,502	24,162
Mortgage-backed U.S. government agencies .....	0	0	0	8,112	8,112
Equity securities .....	0	0	0	3,253	3,253
Total	\$ 220	11,917	15,022	23,367	50,526
		After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	Total
<u>Weighted Average Yields</u>					
U.S. Treasury and U.S. government agencies .....	0	3.98	4.04	4.50	4.08
State and political subdivision obligations .....	7.71	6.68	6.90	6.75	6.82
Mortgage-backed U.S. government agencies .....	0	0	0	4.91	4.91
Equity securities .....	0	0	0	3.00	3.00
Total	7.71	4.64	6.23	5.35	5.45

TABLE 11: LOAN MATURITY AND INTEREST SENSITIVITY

(Dollars in thousands)

	December 31, 2005			
	One Year and Less	After One Year thru Five Years	After Five Years	Total
Commercial, real estate, construction and land development .....	\$ 71,034	114,398	33,953	219,385
Commercial, industrial and agricultural .....	17,853	11,116	2,399	31,368
Real estate-residential mortgages .....	11,054	21,896	11,738	44,688
Consumer .....	3,796	9,746	4,440	17,982
Total Loans	\$ 103,737	157,156	52,530	313,423
<u>Rate Sensitivity</u>				
Predetermined rate .....	\$ 11,646	32,325	46,996	90,967
Floating or adjustable rate .....	92,091	124,831	5,534	222,456
Total	\$ 103,737	157,156	52,530	313,423

TABLE 12: INTEREST RATE SENSITIVITY GAP

(Dollars in thousands) (As of December 31, 2005)	Expected Maturity Year Ended December 31,						Total	Fair Value
	2006	2007	2008	2009	2010	Thereafter		
<b>Assets:</b>								
Interest bearing balances .....	\$ 41,178	396	5,843	7,033	99	0	54,549	54,549
Average interest rate.....	4.04	4.50	3.76	3.92	4.40	-	4.00	
Debt securities .....	220	2,550	4,895	1,725	2,747	38,389	50,526	50,878
Average interest rate.....	7.71	4.90	3.90	4.03	6.11	5.35	5.45	
Adjustable rate loans.....	92,091	19,688	42,182	28,758	34,203	5,534	222,456	222,456
Average interest rate.....	7.33	6.65	6.25	6.22	6.52	5.80	6.76	
Fixed rate loans.....	11,646	10,183	7,578	8,054	6,510	46,996	90,967	88,991
Average interest rate.....	6.65	6.46	6.75	6.59	6.77	6.47	6.55	
<b>Total</b>	<b>\$ 145,135</b>	<b>32,817</b>	<b>60,498</b>	<b>45,570</b>	<b>43,559</b>	<b>90,919</b>	<b>418,498</b>	<b>416,874</b>
<b>Interest liabilities:</b>								
Variable rate savings and transaction accounts .....	\$ 76,049	0	0	0	0	85,602	161,651	161,651
Average interest rate.....	1.75	-	-	-	-	.10	.88	
Certificates of deposit and IRAs .....	68,419	47,964	18,300	15,349	10,576	3,015	163,623	162,359
Average interest rate.....	3.19	3.76	3.56	3.98	4.40	3.92	3.56	
Short term borrowings.....	12,342	0	0	0	0	0	12,342	12,342
Average interest rate.....	4.22	-	-	-	-	-	4.22	
Long term fixed rate borrowings .....	10,125	5,131	15,138	12,145	10,152	7,147	59,838	59,829
Average interest rate.....	4.19	3.71	3.56	4.64	6.50	4.61	4.52	
<b>Total</b>	<b>\$ 166,935</b>	<b>53,095</b>	<b>33,438</b>	<b>27,494</b>	<b>20,728</b>	<b>95,764</b>	<b>397,454</b>	<b>396,181</b>
<b>Rate sensitive gap:</b>								
Periodic gap .....	\$ (21,800)	(20,278)	27,060	18,076	22,831	(4,845)		
Cumulative gap .....	\$ (21,800)	(42,078)	(15,018)	3,058	25,889	21,044		
<b>Cumulative gap as a percentage</b>								
of total assets .....	-5.0%	-9.6%	-3.4%	+0.7%	+5.9%	+4.8%		

(Dollars in thousands) (As of December 31, 2004)	Expected Maturity Year Ended December 31,						Total	Fair Value
	2005	2006	2007	2008	2009	Thereafter		
<b>Assets:</b>								
Interest bearing balances .....	\$ 43,967	3,663	99	5,645	6,934	99	60,407	60,407
Average interest rate.....	2.73	3.32	5.05	3.74	3.91	4.40	3.00	
Debt securities .....	1,240	355	551	4,263	1,925	31,741	40,075	41,129
Average interest rate.....	6.08	7.94	6.21	3.40	4.51	6.19	5.79	
Adjustable rate loans.....	91,696	20,034	22,002	30,896	27,069	4,960	196,657	196,657
Average interest rate.....	5.91	6.65	6.73	6.07	6.25	5.55	6.14	
Fixed rate loans.....	9,371	4,431	10,200	6,235	6,661	45,993	82,891	86,484
Average interest rate.....	6.68	7.10	6.61	6.48	6.49	6.24	6.42	
<b>Total</b>	<b>\$ 146,274</b>	<b>28,483</b>	<b>32,852</b>	<b>47,039</b>	<b>42,589</b>	<b>82,793</b>	<b>380,030</b>	<b>384,677</b>

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

(Dollars in thousands) (As of December 31, 2004)	Expected Maturity						Total	Fair Value
	2005	2006	2007	2008	2009	Thereafter		
Interest liabilities:								
Variable rate savings and								
transaction accounts.....	\$ 59,109	0	0	0	0	85,569	144,678	144,678
Average interest rate.....	0.77					0.12	0.38	
Certificates of deposit and IRAs.....	57,216	33,376	37,993	12,720	13,007	2,154	156,466	157,839
Average interest rate.....	2.75	3.08	3.73	3.46	3.99	3.95	3.24	
Short term borrowings.....	13,801	0	0	0	0	0	13,801	13,801
Average interest rate.....	2.25						2.25	
Long term fixed rate borrowings.....	0	10,000	5,000	5,000	12,000	17,957	49,957	53,081
Average interest rate.....	-	4.19	3.71	3.08	5.63	5.68	4.91	
Total	\$ 130,126	43,376	42,993	17,720	25,007	105,680	364,902	369,399
Rate sensitive gap:								
Periodic gap.....	\$ 16,148	(14,893)	(10,141)	29,319	17,582	(22,887)		
Cumulative gap.....	\$ 16,148	1,255	(8,886)	20,433	38,015	15,128		
Cumulative gap as a percentage								
of total assets.....	+4.0%	+0.3	-2.2	+5.1	+9.4	+3.8		

During 2005, Management analyzed interest rate risk using the Profit Star Asset-Liability Management Model. Using the computerized model, Management reviews interest rate risk on a monthly basis. This analysis includes an earnings scenario whereby interest rates are increased by 200 basis points and another whereby they are decreased by 200 basis points. These scenarios indicate that there would not be a significant variance in net interest income at the one-year time frame due to interest rate changes; however, actual results could vary significantly from the calculations prepared by Management. At December 31, 2005, all interest rate risk levels according to our model were within the tolerance limits of Board approved policy. The model noted above utilized by Management to create the reports used for Table 12 makes various assumptions and estimates. Actual results could differ significantly from these estimates which would result in significant differences in cash flows. In addition, the table does not take into consideration changes which Management would make to realign its portfolio in the event of a changing rate environment.

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

(Dollars in thousands)	December 31,		
	2005	2004	2003
Three months or less.....	\$ 8,421	7,431	4,821
Over three months to twelve months.....	12,930	6,771	7,104
Over twelve months.....	12,868	13,681	12,673
Total	\$ 34,219	27,883	24,598

### Effects of Inflation

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

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

Off-Balance Sheet Items

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

As of December 31, 2005, commitments to extend credit amounted to \$64,795,000 as compared to \$61,028,000 as of December 31, 2004.

MPB also issues financial standby letters of credit to its customers. The risk associated with financial standby letters of credit is essentially the same as the credit risk involved in loan extensions to customers. Financial standby letters of credit decreased to \$10,102,000 at December 31, 2005, from \$11,904,000 at December 31, 2004.

Comprehensive Income

Comprehensive Income is a measure of all changes in equity of a corporation, excluding transactions with owners in their capacity as owners (such as proceeds from issuances of stock and dividends). The difference between Net Income and Comprehensive Income is termed "Other Comprehensive Income." For MPB, Other Comprehensive Income consists of unrealized gains and losses on available-for-sale securities, net of deferred income tax. Comprehensive Income should not be construed to be a measure of net income. The effect of Other Comprehensive Income would only be reflected in the income statement if the entire portfolio of available-for-sale securities were sold on the statement date. The amount of unrealized gains or losses reflected in Comprehensive Income may vary widely at statement dates depending on the markets as a whole and how the portfolio of available-for-sale securities is affected by interest rate movements. Other Comprehensive (Loss) Income for the years ended December 31, 2005, 2004 and 2003 was \$(462,000), \$(722,000) and \$58,000, respectively.

Summary of Selected Financial Data

(Dollars in thousands, except per share data)

	2005	2004	2003	2002	2001
<b>INCOME:</b>					
Total Interest Income .....	\$ 23,294	20,077	19,984	21,352	22,864
Total Interest Expense .....	9,557	8,005	8,434	9,926	11,735
Net Interest Income .....	13,737	12,072	11,550	11,426	11,129
Provision for Possible Loan and Lease Losses .....	225	725	290	425	500
Noninterest Income .....	2,953	3,457	2,707	2,022	1,845
Noninterest Expense .....	10,262	9,030	8,099	7,258	7,026
Income Before Income Taxes .....	6,203	5,774	5,868	5,765	5,448
Provision for Income Taxes .....	1,600	1,405	1,253	1,270	1,218
Net Income .....	4,603	4,369	4,615	4,495	4,230
<b>COMMON STOCK DATA PER SHARE:</b>					
Earnings Per Share .....	\$ 1.37	1.30	1.38	1.34	1.27
Cash Dividends Declared, historical .....	.80	1.80	.80	.80	.80
Stockholders' Equity .....	11.01	10.53	11.16	10.51	9.47
<b>AVERAGE SHARES OUTSTANDING .....</b>	<b>3,348,299</b>	<b>3,348,310</b>	<b>3,347,929</b>	<b>3,347,750</b>	<b>3,350,342</b>
<b>AT YEAR-END:</b>					
Investments .....	\$ 54,549	44,613	54,093	58,859	55,348
Loans, Net of Unearned Discount .....	311,837	279,547	232,078	221,353	202,836
Allowance for Loan Losses .....	3,704	3,643	2,992	3,051	2,856
Total Assets .....	438,110	403,256	373,466	363,284	330,635
Total Deposits .....	325,274	301,144	288,338	274,703	254,105
Short-term Borrowings .....	12,342	13,801	9,688	18,156	9,610
Long-term Debt .....	59,838	49,957	35,684	32,383	32,568
Stockholders' Equity .....	\$ 36,861	35,272	37,361	35,204	31,716
<b>RATIOS:</b>					
Return on Average Assets .....	1.10	1.12	1.25	1.32	1.31
Return on Average Stockholders' Equity .....	12.87	12.73	12.69	13.60	13.68
Cash Dividend Payout Ratio .....	55.56	131.38	54.48	54.05	57.55
Allowance for Loan Losses to Loans .....	1.30	1.30	1.29	1.38	1.41
Average Stockholders' Equity to Average Assets .....	8.55	8.75	9.97	9.67	9.67

**DIRECTORS**

Mid Penn Bancorp, Inc.  
Mid Penn Bank

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

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

**A. James Durica**  
CPA - Consultant

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

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

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

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

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

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

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

**DIRECTORS EMERITI**

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

**EXECUTIVE OFFICERS**

Mid Penn Bancorp, Inc.

**Eugene F. Shaffer**  
Chairman

**William G. Nelson**  
Vice Chairman

**Alan W. Dakey**  
President and CEO

**Kevin W. Laudenslager**  
Treasurer

**Cindy L. Wetzel**  
Secretary

**SENIOR MANAGEMENT**

Mid Penn Bank

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

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

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

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

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

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

**Leonard K. Beasom, Jr.**  
Vice President and Commercial Loan Officer  
*34 Years Banking Experience*

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

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

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

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

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

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

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

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

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

**Rick E. Witwer**  
Vice President and Commercial Loan Officer  
*18 Years Banking Experience*

**CAPITAL AREA ADVISORY BOARD**

Mid Penn Bank

Robert C. Grubic  
Norman K.A. Hoffer  
Norman L. Houser  
Theodore W. Mowery  
Robert M. Newbery  
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Locations

Millersburg  
717.692.2133

Elizabethville  
717.362.8147

Dalmatia  
570.758.2711

Tower City  
717.647.2157

Lykens  
717.453.7185

Halifax  
717.896.8258

Dauphin  
717.921.8899

Harrisburg  
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