



# MID PENN BANK

*Making things happen for you.™*

2006 ANNUAL REPORT

COMMUNITY IS THE KEY TO A BRIGHT FUTURE

## GIVING BACK TO OUR COMMUNITY



Mid Penn Bank knows that a strong community is the key to a bright future. A strong community stimulates small business growth, provides for home ownership possibilities, presents savings and investment options, creates new employment opportunities and enhances the quality of life for its members. Most importantly, a strong community reciprocates its successes. Because Mid Penn Bank's investments flow back into the communities in which we serve, we are ensuring growth and enhancement of these communities and also growth for other businesses. Being able to give back to the community that has allowed Mid Penn Bank to prosper for more than 135 years is Mid Penn Bank's reciprocal gift to the community that has embraced us for so many years.

In July of 2006, Mid Penn Bank announced that it would be donating its historic Elizabethtown building located at the square in Elizabethtown to the Northern Dauphin County Revitalization Project (NDCRP). Mid Penn Bank is relocating the Elizabethtown office in 2007 to a new building being constructed at 4642 State Route 209. While the new office will provide customers with much needed conveniences, the gift of our existing building will provide a new home and serve as central headquarters for the NDCRP. The NDCRP is very involved in new initiatives that will bring economic development, downtown revitalization, tourism and job training to the communities of the Northern Dauphin County region.

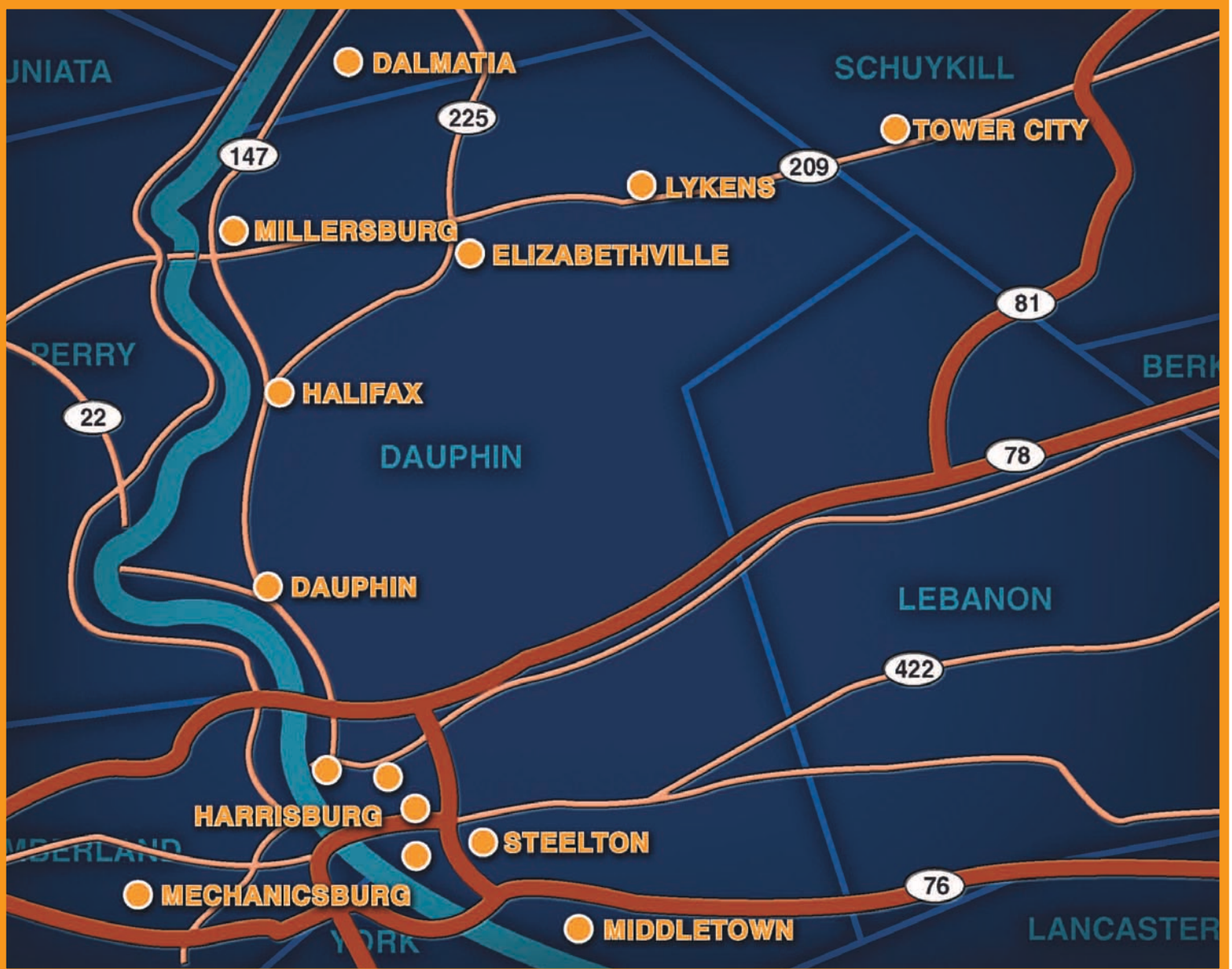
Mid Penn Bank also partnered with the Federal Home Loan Bank of Pittsburgh (FHLBank) to provide \$4.4 million in innovative financing to Cole Crest Rehab in Steelton, Dauphin County. The Housing and Redevelopment Authorities of Dauphin County (HACD) broke ground on the largest rehabilitation project in its history. The ground-breaking ceremony, held at Cole Crest apartments in the Borough of Steelton, provides affordable housing with low-cost funding provided to Mid Penn Bank by the FHLBank. Mid Penn Bank's support of much-needed renovations is part of the Bank's growing commitment to businesses and non-profits across Central Pennsylvania, as several communities are involved in major revitalization projects.

Mid Penn Bank is one of four area banks participating in HACD's Family Savings Account Program, which encourages lower-income families to save money and achieve financial self-sufficiency through regular deposits that are matched by the Commonwealth of PA.

Mid Penn Bank donates to our local volunteer fire company and ambulance associations on an annual basis. The donations program has been in place for approximately 20 years, and over the years, the Bank has donated hundreds of thousands of dollars to these well-deserving organizations. The donation program is based on the relationship of the associations with the bank and the Bank's earnings, which again allows the Bank's successes to flow back into the community as a whole.

Through these, and many other initiatives, Mid Penn Bank is extremely fortunate to be able to give back to the communities that have given us so much. While a strong community is the key to a bright future, we all have an obligation to do our part.

  
**MID PENN BANK**  
*Making things happen for you.™*



BRANCH LOCATIONS

SERVING CENTRAL PENNSYLVANIA



Dear Shareholders:

I am pleased to present the 2006 Annual Report for Mid Penn Bancorp, Inc. The year was one of strong growth in assets and favorable growth in earnings when taking into consideration the challenging interest rate environment for financial institutions.

Net income for the year of \$4,888,000 increased from \$4,603,000 the prior year. On a per share basis, net income increased by 7% to \$1.46 for 2006 compared to \$1.37 for 2005. The increase in income was primarily attributable to a strong improvement in net interest income, which increased \$1,745,000 or 12.7% from the prior year.

Total assets at year end of \$491 million increased by \$53 million, a 12.2% growth rate. Asset growth was attributable to strong loan growth, with net loans increasing by 15% over the prior year. The acquisition of the Steelton and Middletown offices from Omega Bank, which were acquired in December of 2006, added \$27 million in deposits and \$16 million in loan balances. The growth in loans had a positive impact on the improvement in net interest income resulting from the higher earnings rate on loans compared to other investment alternatives.

Your Bank continues to maintain strong capital ratios, well above regulatory requirements. Total capital of \$39,085,000 at year end was 8% of total assets. Return on equity, a widely recognized performance indicator, was 12.93% in 2006, compared to 12.87% in 2005.

## 2006 ANNUAL REPORT LETTER TO OUR SHAREHOLDERS

The past and future success of your Bank is dependent upon the quality of people managing and directing the Bank. Our positive performance in 2006 was the result of dedicated directors, managers and employees. I would like to recognize individuals who have been significant contributors to the success of Mid Penn Bancorp, Inc. Eugene F. Shaffer joined the Bank in 1969 and served as President and CEO until 1993 and as Chairman of the Board until his retirement in April of 2006. Mr. Shaffer contributed substantially to the growth and success of the bank during his 38 years of service to the Bank. William G. Nelson joined the Board of Directors in 1970 and served as a dedicated director and Vice Chairman of the Board until his retirement from the Board in April 2006, having provided 36 years of dedicated service. The contributions of these individuals were significant and appreciated by all those associated with the Bank. I would also like to pay tribute to Guy F. Bucher who passed away in July 2006, who served as a director from 1951 to 1980 with the former Farmers State Bank of Dalmatia, which merged with Mid Penn Bank in 1971.

Looking forward to 2007, we are excited about the opening of our newly relocated Elizabethtown office. This office bears the prototype design we plan to use for future new offices. We are looking to further branch expansion through the construction of an additional office in the Capital Region, as well as continuing to seek branch purchases that would allow us to grow our franchise and contribute to earnings.

Thank you for your continuing support of Mid Penn Bancorp, Inc. Please consider Mid Penn Bank for all your banking needs. Why not bank with the Bank that you have invested in? 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,



Alan W. Dakey  
Chairman, President and CEO



## MILESTONES REACHED

### EUGENE F. SHAFFER

Congratulations to Eugene F. Shaffer, retired Chairman of Mid Penn Bancorp, Inc., who in 2006 was recognized by the Pennsylvania Bankers Association (PBA) for his fifty years in banking. Shaffer joined Mid Penn Bank in 1969 and served as President and CEO until 1993, then serving as Chairman of the Board until his retirement in April of 2006, with 38 years of valuable service to Mid Penn Bank.

## TAKING A LOOK AT OUR NEWEST BRANCHES



### ELIZABETHVILLE BRANCH

Our relocated Elizabethville office will open for business on February 26, 2007 at 4642 State Route 209, Elizabethville. The new office will provide increased convenience, security and parking for our customers. This new, functional office design will serve as the prototype for new offices as Mid Penn Bank pursues future expansion plans and site development opportunities.



### STEELTON BRANCH

On December 4, 2006, Mid Penn Bank acquired the former Steelton office of Omega Bank. Mid Penn Bank is pleased to provide community banking to the residents of Steelton and the surrounding communities. We look forward to working with the community and the leaders of the "New Steelton," as the borough continues its revitalization efforts. "An exciting future is just around the corner."



### MIDDLETOWN BRANCH

On December 4, 2006, Mid Penn Bank acquired the former Middletown office of Omega Bank. Mid Penn Bank is looking forward to providing the residents of Middletown and surrounding communities with the services of our local, independent bank, which has been serving neighbors and friends since 1868. With the acquisition of the two former Omega branches, Mid Penn Bank has reached a new milestone as well, with 14 offices throughout central Pennsylvania to serve our customers.

## NORTHERN REGION LOCATIONS

Millersburg - 349 Union Street / Millersburg, PA 17061 • 717.692.2133

Elizabethville - 4642 State Route 209 / 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

Middletown - 1100 Spring Garden Drive / Middletown, PA 17057 • 717.985.0100

Steelton - 51 South Front Street / Steelton, PA 17113 • 717.939.1966



Member FDIC

2006 ANNUAL REPORT FINANCIAL HIGHLIGHTS



2006 ANNUAL REPORT FINANCIAL HIGHLIGHTS

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**AS OF AND FOR YEARS ENDED DECEMBER 31, 2006 AND 2005**

(Dollars in thousands, except per share data.)

	<u>2006</u>	<u>2005</u>	<u>Percent Change</u>
Total Assets.....	\$ 491,694	438,110	+12.23%
Total Deposits.....	364,226	325,274	+11.98%
Net Loans and Leases.....	354,386	308,133	+15.01%
Total Investments and Interest Bearing Balances.....	104,182	105,427	-1.18%
Stockholders' Equity.....	39,085	36,861	+6.03%
Net Income.....	4,888	4,603	+6.19%
Earnings Per Share.....	1.46	1.37	+6.57%
Cash Dividend Per Share, historical.....	.80	.80	0.00%
Book Value Per Share.....	11.68	11.01	+6.09%
Return on Average Stockholders' Equity.....	12.93%	12.87%	+0.47%
Return on Average Assets.....	1.08%	1.10%	-1.82%
Net Interest Margin.....	3.82%	3.67%	+4.09%
Nonperforming Assets to Total Assets.....	0.50%	0.76%	-34.21%

Mid Penn Bancorp, Inc.

Stockholders' Information

		<u>2006</u>		<u>2005</u>		<u>Quarter</u>
		<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	
Market Value Per Share.....	\$	27.20	25.00	27.70	25.10	1st
		26.60	24.30	25.40	24.60	2nd
		25.50	23.00	27.00	25.35	3rd
		26.08	23.90	25.85	24.20	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, 2006, there were 1,068 registered stockholders.

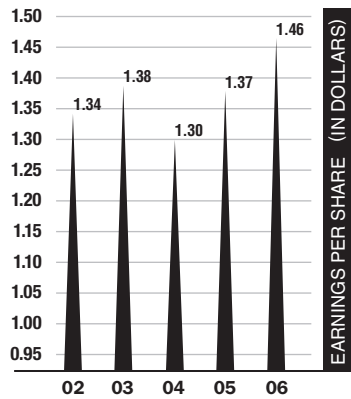
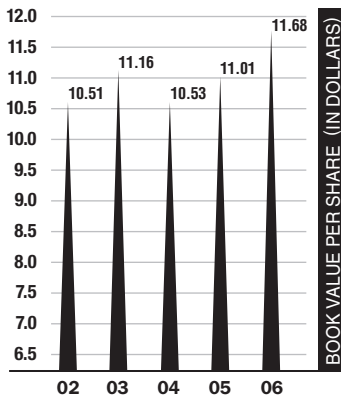
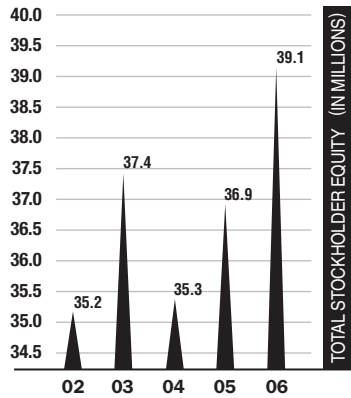
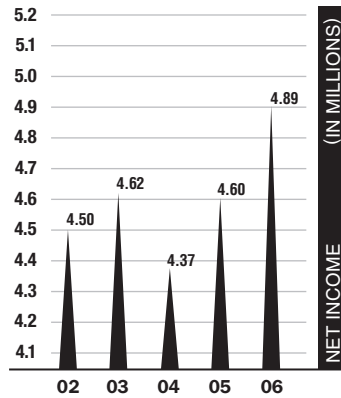
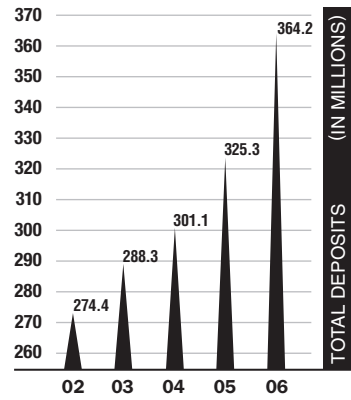
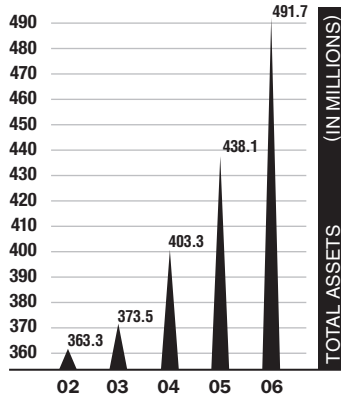
Dividends: A dividend of \$.20 per share was paid during each quarter of 2006. Mid Penn Bancorp, Inc. plans to continue a quarterly dividend payable in February, May, August and November. Additionally, a 5% stock dividend was paid in February of 2006.

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 24, 2007, 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)



# 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, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. 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, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 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, 2006, 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 26, 2007 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 26, 2007

## DECEMBER 31, 2006 AND 2005

(Dollars in thousands, except share data)

	2006	2005
ASSETS		
Cash and due from banks.....	\$ 9,498	6,350
Interest-bearing balances with other financial institutions .....	46,921	54,549
Available-for-sale investment securities.....	57,261	50,878
Loans and leases.....	360,336	313,423
Less:		
Unearned income .....	(1,763)	(1,586)
Allowance for loan and lease losses .....	(4,187)	(3,704)
Net loans and leases .....	<u>354,386</u>	<u>308,133</u>
Bank premises and equipment, net .....	9,562	6,334
Foreclosed assets held for sale .....	146	458
Accrued interest receivable .....	2,822	2,269
Deferred income taxes .....	1,610	1,392
Goodwill .....	1,016	259
Core deposit intangible, net .....	428	235
Cash surrender value of life insurance.....	7,154	6,402
Other assets.....	890	851
Total Assets	<u>\$ 491,694</u>	<u>438,110</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand .....	\$ 44,097	41,719
Interest-bearing demand .....	32,978	31,686
Money market.....	59,640	61,421
Savings .....	25,397	26,825
Time .....	<u>202,114</u>	<u>163,623</u>
Total Deposits	364,226	325,274
Short-term borrowings.....	24,275	12,342
Accrued interest payable .....	1,912	1,535
Other liabilities .....	2,483	2,260
Long-term debt .....	<u>59,713</u>	<u>59,838</u>
Total Liabilities	<u>452,609</u>	<u>401,249</u>
Stockholders' Equity:		
Common stock, par value \$1 per share; authorized 10,000,000 shares; 3,367,119 shares and 3,207,912 shares issued in 2006 and 2005, respectively .....	3,367	3,208
Additional paid-in capital .....	27,452	23,472
Retained earnings .....	8,583	10,486
Accumulated other comprehensive income.....	317	231
Treasury stock, at cost (23,038 and 19,056 shares at December 31, 2006 and 2005, respectively).....	<u>(634)</u>	<u>(536)</u>
Stockholders' Equity, Net	<u>39,085</u>	<u>36,861</u>
Total Liabilities and Stockholders' Equity	<u>\$ 491,694</u>	<u>438,110</u>

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

**FOR YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**

(Dollars in thousands, except share data)	2006	2005	2004
<b>INTEREST INCOME</b>			
Interest and fees on loans .....	\$ 23,455	19,251	16,327
Interest on interest-bearing balances .....	2,225	2,067	1,809
Interest and dividends on investment securities:			
U.S. Treasury and government agencies .....	1,032	801	599
State and political subdivision obligations, tax-exempt .....	1,287	1,030	1,286
Other securities .....	186	92	49
Interest on federal funds sold and securities purchased under agreement to resell .....	29	53	7
Total Interest Income	<u>28,214</u>	<u>23,294</u>	<u>20,077</u>
<b>INTEREST EXPENSE</b>			
Interest on deposits.....	8,868	6,521	5,624
Interest on short-term borrowings .....	686	203	137
Interest on long-term debt .....	3,178	2,833	2,244
Total Interest Expense	<u>12,732</u>	<u>9,557</u>	<u>8,005</u>
Net Interest Income	15,482	13,737	12,072
PROVISION FOR LOAN AND LEASE LOSSES .....	735	225	725
Net Interest Income After Provision for Loan and Lease Losses	<u>14,747</u>	<u>13,512</u>	<u>11,347</u>
<b>NONINTEREST INCOME</b>			
Trust department income.....	258	312	248
Service charges on deposits.....	1,376	1,348	1,467
Investment securities gains, net .....	33	1	475
Gain on sale of loans.....	0	19	0
Income on cash surrender value of life insurance.....	219	222	211
Fee income from investment services .....	112	70	162
Fee income from debit card transactions .....	271	223	169
Gain on sale of other real estate.....	104	56	0
Other income .....	655	702	725
Total Noninterest Income	<u>3,028</u>	<u>2,953</u>	<u>3,457</u>
<b>NONINTEREST EXPENSE</b>			
Salaries and employee benefits.....	6,023	5,662	4,918
Occupancy expense, net .....	622	594	456
Equipment expense.....	838	734	631
Pennsylvania bank shares tax expense .....	286	259	265
Legal and professional expense .....	733	540	457
Early withdrawal penalty on investment CDs .....	191	0	0
Marketing and advertising.....	255	298	185
Debit card processing expense .....	129	154	214
Director fees and benefits expense.....	241	221	196
Other expenses .....	1,945	1,800	1,708
Total Noninterest Expense	<u>11,263</u>	<u>10,262</u>	<u>9,030</u>
INCOME BEFORE PROVISION FOR INCOME TAXES .....	6,512	6,203	5,774
Provision for income taxes .....	1,624	1,600	1,405
NET INCOME	<u>\$ 4,888</u>	<u>4,603</u>	<u>4,369</u>
EARNINGS PER SHARE	<u>\$ 1.46</u>	<u>1.37</u>	<u>1.30</u>
Weighted Average Number of Shares Outstanding	<u>3,347,448</u>	<u>3,348,299</u>	<u>3,348,310</u>

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

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

## FOR YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(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, 2003.....	3,208	23,472	9,805	1,415	(539)	<u>37,361</u>
Comprehensive income:						
Net income.....	0	0	4,369	0	0	4,369
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects.....	0	0	0	(722)	0	<u>(722)</u>
Total comprehensive income						<u>3,647</u>
Cash dividends (\$1.80 per share).....	0	0	(5,739)	0	0	(5,739)
Sale of treasury stock (322 shares).....	0	0	0	0	3	<u>3</u>
Balance, December 31, 2004.....	3,208	23,472	8,435	693	(536)	<u>35,272</u>
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	<u>(462)</u>
Total comprehensive income						<u>4,141</u>
Cash dividends (\$ .80 per share).....	0	0	(2,552)	0	0	<u>(2,552)</u>
Balance, December 31, 2005.....	3,208	23,472	10,486	231	(536)	<u>36,861</u>
Comprehensive income:						
Net income.....	0	0	4,888	0	0	4,888
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effects.....	0	0	0	60	0	<u>60</u>
Adjustments to initially apply FASB Statement No. 158, net of tax						
Net transition obligation.....	0	0	0	(58)	0	(58)
Net gain.....	0	0	0	84	0	<u>84</u>
Total comprehensive income						<u>4,974</u>
Cash dividends (\$ .80 per share).....	0	0	(2,652)	0	0	(2,652)
Stock dividend 5% issued February 2006.....	159	3,980	(4,139)	0	0	0
Purchase of treasury stock (3,982 shares).....	0	0	0	0	(98)	<u>(98)</u>
Balance, December 31, 2006.....	<u>\$ 3,367</u>	<u>27,452</u>	<u>8,583</u>	<u>317</u>	<u>(634)</u>	<u>39,085</u>

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

**FOR YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**

(Dollars in thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating Activities:			
Net income .....	\$ 4,888	4,603	4,369
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses.....	735	225	725
Depreciation .....	638	579	475
Amortization of core deposit intangible .....	39	36	20
Increase in cash surrender value of life insurance.....	(219)	(222)	(211)
Investment securities gains, net.....	(33)	(1)	(475)
(Gain) loss on sale of foreclosed assets .....	(104)	(66)	4
(Gain) on sale of loans .....	0	(19)	0
(Gain) loss on disposal of bank premises and equipment .....	(9)	2	0
Deferred income taxes .....	(262)	(173)	(307)
Change in accrued interest receivable .....	(464)	(394)	(112)
Change in other assets.....	(25)	(143)	142
Change in accrued interest payable.....	266	343	147
Change in other liabilities .....	241	370	540
Net Cash Provided By Operating Activities	<u>5,691</u>	<u>5,140</u>	<u>5,317</u>
Investing Activities:			
Net decrease in interest-bearing balances .....	7,628	5,858	9,511
Proceeds from the maturity of investment securities.....	5,546	4,798	7,979
Proceeds from the sale of investment securities .....	1,923	535	17,195
Purchases of investment securities .....	(13,728)	(12,297)	(16,305)
Purchase of life insurance .....	(533)	0	(1,016)
Cash received from business combination.....	7,100	0	4,139
Proceeds from sale of loans.....	0	348	0
Net increase in loans.....	(31,011)	(33,241)	(45,163)
Proceeds from sale of bank premises and equipment.....	13	40	0
Purchases of bank premises and equipment.....	(1,044)	(2,081)	(1,429)
Proceeds from the sale of foreclosed assets.....	746	571	879
Capitalized additions - foreclosed assets .....	0	0	(147)
Net Cash Used In Investing Activities	<u>(23,360)</u>	<u>(35,469)</u>	<u>(24,357)</u>
Financing Activities:			
Net increase in deposits.....	11,759	24,130	5,613
Net increase (decrease) in short-term borrowings.....	11,933	(1,459)	4,113
Cash dividends paid.....	(2,652)	(2,552)	(5,739)
Long-term debt repayment .....	(10,125)	(119)	(5,127)
(Purchase) sale of treasury stock.....	(98)	0	3
Long-term borrowings .....	10,000	10,000	19,400
Net Cash Provided By Financing Activities	<u>20,817</u>	<u>30,000</u>	<u>18,263</u>
Net increase (decrease) in cash and due from banks .....	3,148	(329)	(777)
Cash and due from banks at beginning of year .....	<u>6,350</u>	<u>6,679</u>	<u>7,456</u>
Cash and due from banks at end of year.....	<u>\$ 9,498</u>	<u>6,350</u>	<u>6,679</u>
Supplemental Disclosures of Cash Flow Information:			
Interest paid.....	\$ 12,355	9,214	7,858
Income taxes paid .....	\$ 1,910	1,876	1,385
Supplemental Noncash Disclosures:			
Loan charge-offs.....	\$ 309	199	74
Transfers to foreclosed assets held for sale .....	\$ 330	458	124

Business Combination:

(Dollars in thousands)

	<u>2006</u>		<u>2005</u>		<u>2004</u>
<u>Investing Activities:</u>					
Cash received from business combination .....	\$ 7,100	\$	-	\$	4,139

Supplemental Noncash Disclosures:

## Noncash Assets Received and Liabilities

## Assumed from Acquisition of Branches

## Assets received:

Loans .....	\$ 16,307		-		2,483
Accrued Interest receivable .....	89		-		-
Bank premises and equipment .....	2,826		-		-
Intangible asset - core deposit intangible .....	232		-		291
Intangible asset - goodwill .....	757		-		259
Other assets .....	14		-		21
Total noncash assets received .....	\$ 20,225	\$	-	\$	3,054

## Liabilities assumed:

Deposits .....	27,193		-		7,193
Accrued interest payable .....	111		-		-
Other liabilities .....	21		-		-
Total noncash liabilities assumed .....	\$ 27,325		-		\$ 7,193

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 fourteen offices located in 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 - includes debt and restricted equity securities. Debt securities are reported at fair value, with unrealized holding gains and losses excluded from earnings and reported, net of deferred income taxes, as a component of accumulated other comprehensive income (loss) within stockholders' equity. Realized gains and losses on sales of investment securities are computed on the basis of specific identification of the cost of each security. Restricted equity securities are generally carried at cost and evaluated for impairment due to the lack of available market data. Restricted equity securities for which market data is available are reported at fair value. MPB had no trading securities or held-to-maturity securities in 2006 or 2005.

**(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 disposals are reflected in current operations.

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

Foreclosed assets held for sale consist primarily 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 disposal 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. The core deposit intangible is subject to impairment testing whenever events or changes in circumstances indicate its carrying amount may not be recoverable.

(i) **Goodwill**

Goodwill is the excess of the purchase price over the fair value of assets acquired in connection with 2004 and 2006 business acquisitions accounted for as purchases. Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," requires a two-step process for testing the impairment of goodwill on at least an annual basis. No impairment of goodwill was recognized in 2004, 2005 or 2006.

(j) **Marketing and Advertising Costs**

Marketing and advertising costs are expensed as incurred and were \$255,000 in 2006, \$298,000 in 2005, and \$185,000 in 2004.

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

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

(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) Adoption of New Accounting Principle**

Effective December 31, 2006, MPB adopted Financial Accounting Standards Board (FASB), Statement of Financial Accounting Standards (SFAS) No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS No. 158 requires, among other things, that an employer measure the funded status of a defined benefit pension plan in its balance sheet. The funded status is measured as the difference between plan assets at fair value and the benefit obligation. For a pension plan, the benefit obligation is the projected benefit obligation; for any other postretirement benefit plan, it is the accumulated postretirement benefit obligation.

Changes in the funded status will be recognized through a change in other comprehensive income in the year the change occurs. Amounts recognized in the balance sheet, including the gains or losses, prior service costs or application of SFAS No. 87, Employers' Accounting for Pensions, are adjusted as they are subsequently recognized as components of net periodic benefit costs pursuant to the recognition and measurement provisions of that statement. It also requires that an employer measure the funded status of a plan as of its balance sheet date for fiscal years ending after December 15, 2008. The adoption of SFAS No. 158 did not have a material effect on MPB's financial statements.

The incremental effect of applying SFAS No. 158 on individual line items in the consolidated balance sheet is as follows:

(Dollars in thousands)	Before application of Statement 158	Adjustments	After application of Statement 158
Deferred income taxes .....	\$ 1,624	\$ (14)	\$ 1,610
Total Assets .....	491,708	(14)	491,694
Other Liabilities .....	2,523	(40)	2,483
Total Liabilities .....	452,649	(40)	452,609
Accumulated other comprehensive income .....	291	26	317
Total stockholders' equity .....	39,059	26	39,085

The estimated net gain and transition obligation expected to be recognized in net periodic benefit cost in the upcoming fiscal year for the plans are as follows:

(Dollars in thousands)	Net Gain	Transition obligation
Defined Benefit Pension Plan .....	\$ -	\$ -
Postretirement Life and Health Plan .....	3	(15)
Total .....	<u>\$ 3</u>	<u>\$ (15)</u>

**(5) Comprehensive Income**

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

(Dollars in thousands)	Years Ended December 31,		
	2006	2005	2004
Change in unrealized holding gains (losses) on available-for-sale securities .....	\$ 123	(699)	(619)
Less reclassification adjustment for gains realized in income .....	(33)	(1)	(475)
Net unrealized (losses) gains .....	90	(700)	(1,094)
Other comprehensive income related to SFAS No. 158 .....	40	0	0
Income tax benefit (expense) .....	(44)	238	372
Net .....	<u>\$ 86</u>	<u>(462)</u>	<u>(722)</u>

**(6) 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 \$512,000 at December 31, 2006 and \$480,000 at December 31, 2005.

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

**(7) Investment Securities**

At December 31, 2006 and 2005, amortized cost, fair value, and unrealized gains and losses on investment securities are as follows:

(Dollars in Thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2006				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies .....	\$ 15,015	15	194	14,836
Mortgage-backed U.S. government agencies .....	9,041	28	95	8,974
State and political subdivision obligations .....	29,050	711	14	29,747
Restricted equity securities .....	3,713	0	9	3,704
	<u>\$ 56,819</u>	<u>754</u>	<u>312</u>	<u>57,261</u>

(Dollars in Thousands)

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
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
	<u>\$ 50,526</u>	<u>853</u>	<u>501</u>	<u>50,878</u>

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

Restricted equity securities consist of stock in the Federal Home Loan Bank of Pittsburgh and Atlantic Central Bankers Bank which do not have a readily determinable fair value because their ownership is restricted and they lack a market. Also included in restricted equity securities is an investment in Access Capital Strategies, an equity fund that invests in low to moderate income financing projects. This investment was purchased in 2004 to help fulfill the Bank's regulatory requirement of the Community Reinvestment Act and at December 31, 2005 and December 31, 2006 is reported at fair value.

Investment securities having a fair value of \$44,913,000 at December 31, 2006 and \$36,385,000 at December 31, 2005, were pledged to secure public deposits and other borrowings.

Gains from sales of investment securities amounted to \$33,000 in 2006, \$1,000 in 2005 and \$475,000 in 2004. The proceeds from sales of investment securities were \$1,923,000 in 2006, \$535,000 in 2005 and \$17,195,000 in 2004.

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, 2006 and 2005.

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2006						
Available-for-sale securities:						
U.S. Treasury and U.S. government agencies .....	\$ 0	0	13,806	194	13,806	194
Mortgage-backed U.S. government agencies .....	0	0	5,822	95	5,822	95
State and political subdivision obligations .....	1,954	5	1,293	9	3,247	14
Restricted equity securities .....	0	0	241	9	241	9
Total temporarily impaired available-for-sale securities .....	<u>\$ 1,954</u>	<u>5</u>	<u>21,162</u>	<u>307</u>	<u>23,116</u>	<u>312</u>

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2005						
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>

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, 2006, the 30 debt securities with unrealized losses have depreciated 0.5% from its amortized cost basis. These securities are guaranteed by either the U.S. Government or other governmental agencies. 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 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, 2006:

(Dollars in thousands)	December 31, 2006		December 31, 2005	
	Amortized	Fair	Amortized	Fair
	Cost	Value	Cost	Value
Due in 1 year or less .....	\$ 2,455	2,451	220	222
Due after 1 year but within 5 years .....	10,722	10,702	11,917	11,861
Due after 5 years but within 10 years.....	17,323	17,623	15,022	15,375
Due after 10 years .....	<u>13,566</u>	<u>13,807</u>	<u>12,002</u>	<u>12,208</u>
	44,066	44,583	39,161	39,666
Mortgage-backed securities (avg. life 1.96 years) .....	9,041	8,974	8,112	7,970
Restricted equity securities .....	<u>3,713</u>	<u>3,704</u>	<u>3,253</u>	<u>3,242</u>
	\$ <u>56,820</u>	<u>57,261</u>	<u>50,526</u>	<u>50,878</u>

### (8) Loans

A summary of loans at December 31, 2006 and 2005 is as follows:

(Dollars in thousands)	2006	2005
Commercial real estate, construction and land development.....	\$ 226,663	219,385
Commercial, industrial and agricultural .....	48,785	31,368
Real estate - residential .....	63,141	44,688
Consumer.....	<u>21,747</u>	<u>17,982</u>
	\$ <u>360,336</u>	<u>313,423</u>

Net unamortized loan fees and costs of \$346,000 in 2006 and \$350,000 in 2005 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 \$6,058,000 at December 31, 2006 and \$2,722,000 at December 31, 2005. New loans extended were \$199,000 in 2006 and \$814,000 in 2005. Outstanding credit to a new director in 2006 amounted to \$3,289,000. Net payments on these loans equalled \$152,000 during 2006 and \$1,075,000 during 2005. 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.

### (9) Allowance for Loan and Lease Losses

Changes in the allowance for loan and lease losses for the years 2006, 2005, and 2004 are summarized as follows:

(Dollars in thousands)	2006	2005	2004
Balance, January 1 .....	\$ 3,704	3,643	2,992
Provision for loan losses .....	735	225	725
Loans charged off .....	(309)	(199)	(121)
Recoveries on loans charged off.....	<u>57</u>	<u>35</u>	<u>47</u>
Balance, December 31 .....	\$ <u>4,187</u>	<u>3,704</u>	<u>3,643</u>

The recorded investment in loans that are considered impaired amounted to \$1,126,000, \$1,126,000 and \$1,013,000 on December 31, 2006, December 31, 2005 and December 31, 2004, 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 \$163,000 at December 31, 2006 and \$150,000 at December 31, 2005. All impaired loans at the end of 2006 and 2005 had related allowances. The average balances of these loans amounted to approximately \$1,739,000, \$1,404,000 and \$945,000 for the years 2006, 2005 and 2004, 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 2006, 2005 and 2004.

(Dollars in thousands)	2006	2005	2004
Cash receipts applied to reduce principal balance .....	\$ 563	23	36
Cash receipts recognized as interest income .....	<u>2</u>	<u>15</u>	<u>3</u>
Total cash receipts.....	\$ <u>565</u>	<u>38</u>	<u>39</u>

Loans which were past due 90 days or more for which interest continued to be accrued amounted to approximately \$900,000 at December 31, 2006 and \$1,002,000 at December 31, 2005. Total nonaccrual loans amounted to \$1,235,000 at December 31, 2006 and \$1,773,000 at December 31, 2005. The Bank has no commitments to loan additional funds to borrowers with impaired or nonaccrual loans.

### (10) Bank Premises and Equipment

At December 31, 2006 and 2005, bank premises and equipment are as follows:

(Dollars in thousands)	<u>2006</u>	<u>2005</u>
Land .....	\$ 2,466	1,823
Buildings .....	7,169	5,172
Furniture and fixtures .....	6,368	5,881
Leasehold improvements .....	133	133
Construction in progress .....	<u>(739)</u>	<u>0</u>
	16,875	13,009
Less accumulated depreciation .....	<u>(7,313)</u>	<u>(6,675)</u>
	<u>\$ 9,562</u>	<u>6,334</u>

Depreciation expense was \$638,000 in 2006, \$579,000 in 2005 and \$475,000 in 2004.

### (11) Deposits

At December 31, 2006 and 2005, time deposits in denominations of \$100,000 or more amounted to \$33,985,000 and \$34,219,000, respectively. Interest expense on such certificates of deposit amounted to approximately \$1,549,000, \$1,036,000 and \$830,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Time deposits at December 31, 2006, mature as follows (in thousands): 2007, \$22,080; 2008, \$9,969; 2009, \$895; 2010, \$693; 2011, \$348.

Brokered deposits included in the deposit totals equalled \$39,849,000 at December 31, 2006 and \$30,338,000 at December 31, 2005. Deposits and other funds from related parties held by MPB at December 31, 2006 and 2005 amounted to approximately \$5,736,000 and \$5,430,000, respectively.

### (12) Short-term Borrowings

Short-term borrowings as of December 31, 2006 and 2005 consisted of:

(Dollars in thousands)	<u>2006</u>	<u>2005</u>
Federal funds purchased .....	\$ 14,500	5,000
Repurchase agreements .....	9,175	6,899
Treasury, tax and loan notes .....	<u>600</u>	<u>443</u>
	<u>\$ 24,275</u>	<u>12,342</u>

The weighted average interest rate on total short-term borrowings outstanding was 4.91% at December 31, 2006 and 4.22% at December 31, 2005.

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 Bank also has unused lines of credit with several banks amounting to \$24,687,297 at December 31, 2006.

### (13) 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, 2006 and 2005, the Bank had long-term debt in the amount of \$59,713,000 and \$59,838,000, respectively, consisting of:

(Dollars in thousands)	At December 31,	
	<u>2006</u>	<u>2005</u>
Loans matured in 2006 with rates ranging from 2.17% to 6.21% .....	\$ 0	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	15,000
Loans maturing in 2009 with rates ranging from 4.22% to 7.24% .....	17,000	12,000
Loans maturing in 2010 with rates ranging from 6.28% to 6.71% .....	10,000	10,000
Loans maturing in 2011 at a rate of 5.13% .....	5,000	0
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% .....	4,122	4,245
Loans maturing in 2027 at a rate of 6.71% .....	<u>91</u>	<u>93</u>
Total Long-term Debt	<u>\$ 59,713</u>	<u>59,838</u>

The aggregate amounts of maturities of long-term debt subsequent to December 31, 2006 are \$5,131,000 (2007), \$15,138,000 (2008), \$12,145,000 (2009), \$10,152,000 (2010), \$5,159,000 (2011), \$11,988,000 thereafter. \$6,561,014 of the Bank's investments, and the bank's mortgage loan portfolio are pledged to secure FHLB borrowings.

#### (14) 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, 2006 and 2005 and a statement of the funded status at December 31, 2006 and 2005:

(Dollars in thousands)	December 31,	
	2006	2005
Change in benefit obligations:		
Benefit obligations, January 1 .....	\$ 720	646
Service cost .....	39	43
Interest cost .....	30	36
Actuarial loss (gain) .....	(146)	16
Benefit payments .....	(19)	(21)
Benefit obligations, December 31 .....	<u>\$ 624</u>	<u>720</u>

Change in fair value of plan assets:

Fair value of plan assets, January 1 .....	\$ 0	0
Employer contributions .....	19	21
Benefit payments .....	(19)	(21)
Fair value of plan assets, December 31 .....	<u>\$ 0</u>	<u>0</u>

(Dollars in thousands)	December 31,	
	2006	2005
Funded status:		
Excess of the benefit obligation over the value of plan assets .....	\$ (624)	(720)
Unrecognized transition obligation .....	0	103
Unrecognized loss (gain) .....	0	20
Net amount recognized .....	<u>\$ (624)</u>	<u>(597)</u>

Amount recognized in the consolidated balance sheet at December 31, 2006 and 2005 is as follows:

(Dollars in thousands)	2006	2005
Accrued benefit liability .....	<u>\$ (624)</u>	<u>(597)</u>

The accumulated benefit obligation for health and life insurance plans was \$624,000 and \$720,000 at December 31, 2006 and 2005, respectively.

The components of net periodic postretirement benefit cost for 2006, 2005 and 2004 are as follows:

(Dollars in thousands)	<u>2006</u>	<u>2005</u>	<u>2004</u>
Service cost .....	\$ 39	43	38
Interest cost .....	30	36	31
Amortization of transition obligation .....	15	15	15
Amortization of net (gain) .....	(4)	0	0
Net periodic postretirement benefit cost .....	<u>\$ 80</u>	<u>94</u>	<u>84</u>

Assumptions used in the measurement of MPB's benefit obligations at December 31, 2006 and 2005 are as follows:

Weighted-average assumptions:	<u>2006</u>	<u>2005</u>
Discount rate .....	5.75%	5.50%
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, 2006, 2005 and 2004 are as follows:

Weighted-average assumptions:	<u>2006</u>	<u>2005</u>	<u>2004</u>
Discount rate .....	5.50%	5.75%	6.00%
Rate of compensation increase .....	5.00%	5.00%	5.00%

Assumed health care cost trend rates at December 31, 2006, 2005 and 2004 are as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Health care cost trend rate assumed for next year .....	9.00%	9.00%	10.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) .....	5.00%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate .....	2010	2009	2009

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 .....	\$ 11	9
Effect on postretirement benefit obligation .....	76	64

MPB expects to contribute \$19,725 to its postretirement benefit plans in 2007.

#### Estimated Future Benefit Payments

1/1/2007 to 12/31/2007 .....	\$ 19,725
1/1/2008 to 12/31/2008 .....	19,444
1/1/2009 to 12/31/2009 .....	24,967
1/1/2010 to 12/31/2010 .....	20,316
1/1/2011 to 12/31/2011 .....	21,772
1/1/2012 to 12/31/2016 .....	218,231

Plan assets and benefit obligations were measured as of December 31, 2006 for the postretirement benefit plan.

A net gain of \$122,698 and a net transition obligation of \$88,363 represent the unrecognized components of accumulated other comprehensive income for the postretirement benefit plan at December 31, 2006.



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, 2006 and 2005 and a statement of the funded status at December 31, 2006 and 2005:

	December 31,	
	<u>2006</u>	<u>2005</u>
(Dollars in thousands)		
Change in benefit obligations:		
Benefit obligations, January 1 .....	\$ 716	712
Service cost .....	19	26
Interest cost .....	37	41
Actuarial (gain) loss .....	(10)	17
Change in assumptions .....	(11)	(57)
Benefit payments .....	(35)	(23)
Benefit obligations, December 31 .....	<u>\$ 716</u>	<u>716</u>

	December 31,	
	<u>2006</u>	<u>2005</u>
(Dollars in thousands)		
Change in fair value of plan assets:		
Fair value of plan assets, January 1 .....	\$ 0	0
Employer contributions .....	35	23
Benefit payments .....	(35)	(23)
Fair value of plan assets, December 31 .....	<u>\$ 0</u>	<u>0</u>

	December 31,	
	<u>2006</u>	<u>2005</u>
(Dollars in thousands)		
Funded status:		
Excess of the benefit obligation over the value of plan assets .....	\$ (716)	(716)
Unrecognized prior-service cost .....	0	0
Unrecognized loss .....	0	17
Net amount recognized .....	<u>\$ (716)</u>	<u>(699)</u>

Amounts recognized in the consolidated balance sheet at December 31, 2006 and 2005 are as follows:

	December 31,	
	<u>2006</u>	<u>2005</u>
(Dollars in thousands)		
Accrued benefit liability .....	\$ (716)	(716)
Intangible asset .....	0	17
Net amount recognized .....	<u>\$ (716)</u>	<u>(699)</u>

The accumulated benefit obligation for the retirement plan was \$716,000 at both December 31, 2006 and 2005.

The components of net periodic retirement cost for 2006, 2005 and 2004 are as follows:

	December 31,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
(Dollars in thousands)			
Service cost .....	\$ 20	26	22
Interest cost .....	37	41	39
Amortization of prior-service cost .....	0	26	26
Net periodic retirement cost .....	<u>\$ 57</u>	<u>93</u>	<u>87</u>

Assumptions used in the measurement of MPB's benefit obligations at December 31, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Weighted-average assumptions:		
Discount rate .....	5.75%	5.50%
Change in consumer price index .....	3.25%	3.00%

Assumptions used in the measurement of MPB's net periodic benefit cost for the years ended December 31, 2006, 2005 and 2004 are as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Weighted-average assumptions:			
Discount rate .....	5.50%	5.75%	6.00%
Rate of compensation increase .....	3.25%	3.00%	4.00%

MPB expects to contribute \$53,277 to its retirement plan in 2007.

Estimated Future Benefit Payments

1/1/2007 to 12/31/2007 .....	\$ 53,277
1/1/2008 to 12/31/2008 .....	59,752
1/1/2009 to 12/31/2009 .....	59,232
1/1/2010 to 12/31/2010 .....	58,497
1/1/2011 to 12/31/2011 .....	57,531
1/1/2012 to 12/31/2016 .....	323,969

Plan assets and benefit obligations were measured as of December 31, 2006 for the directors' defined benefit plan.

A net gain of \$4,964 represents the unrecognized component of accumulated other comprehensive income for the director's defined benefit plan at December 31, 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 \$2,942,000 and \$2,326,000 at December 31, 2006 and 2005, respectively.

### **(15) 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 \$251,000 for 2006, \$277,000 for 2005 and \$307,000 for 2004.

**(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 both December 31, 2006 and 2005, the Bank had accrued a liability of approximately \$140,000 for this plan.

The Bank also has a directors' deferred compensation plan which allows directors to defer receipt of fees for a specified period in order to provide future retirement income. At December 31, 2006 and 2005, the Bank had accrued a liability of approximately \$274,000 and \$237,000, 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 \$1,923,000 and \$1,683,000 at December 31, 2006 and 2005, 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, 2006 and 2005, the Bank has accrued a liability of approximately \$232,000 and \$195,000, respectively, for the Agreement. The expense related to the Agreement was \$37,000 for 2006, \$34,000 for 2005 and \$32,000 for 2004.

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 \$930,000 and \$897,000 at December 31, 2006 and 2005, 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 2006, 2005 and 2004 was \$94,000, \$139,000 and \$155,000, respectively. The ESOP held 40,461 and 36,160 shares of MPB stock as of December 31, 2006 and December 31, 2005, 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, 2006 and 2005, the Bank had Split Dollar Life Insurance arrangements with one existing and one former executive for which the aggregate collateral assignment and cash surrender values are approximately \$1,550,000 and \$1,496,000, respectively.

**(16) Federal Income Taxes**

The following temporary differences gave rise to the net deferred tax asset at December 31, 2006 and 2005:

(Dollars in thousands)	<u>2006</u>	<u>2005</u>
Deferred tax assets:		
Allowance for loan losses .....	\$ 1,270	1,106
Benefit plans .....	703	669
Nonaccrual interest .....	110	78
Core deposit intangible .....	15	8
Total	<u>2,098</u>	<u>1,861</u>
Deferred tax liabilities:		
Depreciation .....	(149)	(162)
Loan fees .....	(117)	(138)
Bond accretion .....	(42)	(27)
Other items .....	(30)	(22)
Unrealized gain on securities .....	(150)	(120)
Total	<u>(488)</u>	<u>(469)</u>
Deferred tax asset, net .....	<u>\$ 1,610</u>	<u>1,392</u>

The provision for income taxes consists of the following:

(Dollars in thousands)	<u>2006</u>	<u>2005</u>	<u>2004</u>
Currently payable .....	\$ 1,886	1,773	1,712
Deferred .....	(262)	(173)	(307)
Total provision for income taxes .....	<u>\$ 1,624</u>	<u>1,600</u>	<u>1,405</u>

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

(Dollars in thousands)	<u>2006</u>	<u>2005</u>	<u>2004</u>
Provision at the expected statutory rate .....	\$ 2,214	2,109	1,963
Effect of tax-exempt income .....	(643)	(533)	(583)
Nondeductible interest .....	66	39	34
Other items .....	(13)	(15)	(9)
Provision for income taxes .....	<u>\$ 1,624</u>	<u>1,600</u>	<u>1,405</u>

**(17) Business Combination**

On December 4, 2006, MPB consummated the purchase of assets and assumption of liabilities of the Middletown and Steelton offices of Omega Bank ("Omega Branches"). MPB approved this deal in order to increase market share in the Central Pennsylvania Area. The net receipt of cash from the Omega Branches was \$7,100,000. The results of operations of these former Omega Branches from the date of acquisition have been included in the accompanying consolidated financial statements.

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

(Dollars in thousands)	<u>2006</u>
Cash .....	\$ 445
Loans .....	16,307
Accrued interest receivable .....	89
Property, plant and equipment .....	2,826
Goodwill .....	757
Core deposit intangible .....	232
Other assets .....	14
Total Assets Acquired .....	<u>\$ 20,670</u>
Deposits .....	\$ 27,193
Accrued interest payable .....	111
Other liabilities .....	21
Total Liabilities Assumed .....	<u>27,325</u>
Net Liabilities Assumed .....	<u>\$ 6,655</u>

Presented herein is certain unaudited pro forma information for 2006 as if the Omega Branches had been acquired on January 1, 2006 and for 2005 as if these former Omega Branches had been acquired on January 1, 2005. These results combine historical results of these former Omega Branches 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		
	2006	2005	2004
Net interest income .....	\$ 15,852	14,107	12,442
Noninterest income .....	3,220	3,145	3,649
Noninterest expense .....	11,505	10,504	9,272
Net income .....	5,208	4,923	4,689
Earnings per share .....	1.55	1.47	1.40

### (18) Core Deposit Intangible

A summary of core deposit intangible is as follows at December 31, 2006.

(Dollars in thousands)	2004	2006	Total
	Acquisition	Acquisition	
Gross carrying amount .....	\$ 291	232	523
Less accumulated amortization .....	(93)	(2)	(95)
Net carrying amount .....	<u>\$ 198</u>	<u>230</u>	<u>428</u>

The core deposit intangibles for the acquisitions are being amortized over the weighted average useful life of 8 years, with no estimated residual value.

Amortization expense amounted to \$39,000 in 2006 and \$36,000 in 2005.

The estimated amortization expense of intangible assets for each of the five succeeding fiscal years is \$65,000 per year.

### (19) 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)	Capital Adequacy				To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Actual:		Minimum Capital Required:		Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2006:						
Tier I Capital (to Average Assets) .....	\$ 36,833	7.9%	18,677	4.0%	23,346	5.0%
Tier I Capital (to Risk Weighted Assets) .....	36,833	9.4	15,610	4.0	23,414	6.0
Total Capital (to Risk Weighted Assets) .....	41,020	10.5	31,219	8.0	39,024	10.0
As of December 31, 2005:						
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, 2006, 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.

**(20) 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, 2006, commitments to extend credit amounted to \$70,630,000 and financial standby letters of credit amounted to \$11,163,000.

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, 2006, 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 \$30,234,000 or 8.5% and \$25,507,000 or 7.2%, respectively, of net loans outstanding as of December 31, 2006.

**(21) 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, 2006 for each of the next 4 years and in the aggregate are:

2007 .....	\$	69,636
2008 .....		71,725
2009 .....		73,877
2010 .....		<u>18,605</u>
	\$	<u>233,843</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.

**(22) 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, 2006 and 2005

(Dollars in thousands)

	<u>2006</u>	<u>2005</u>
ASSETS		
Cash .....	\$ 277	273
Investment in Subsidiaries.....	<u>38,808</u>	<u>36,588</u>
Total Assets	<u>\$ 39,085</u>	<u>36,861</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Stockholders' Equity .....	\$ 39,719	37,397
Less Treasury Stock .....	<u>(634)</u>	<u>(536)</u>
Total Liabilities and Equity	<u>\$ 39,085</u>	<u>36,861</u>

## CONDENSED STATEMENT OF INCOME

For Years Ended December 31, 2006, 2005 and 2004

(Dollars in thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Dividends from Subsidiaries.....	\$ 2,864	2,643	5,774
Other Income from Subsidiaries .....	61	47	23
Undistributed Earnings of Subsidiaries .....	2,134	2,051	(1,361)
Other Expenses .....	<u>(171)</u>	<u>(138)</u>	<u>(67)</u>
Net Income	<u>\$ 4,888</u>	<u>4,603</u>	<u>4,369</u>

## CONDENSED STATEMENT OF CASH FLOWS

For Years Ended December 31, 2006, 2005 and 2004

(Dollars in thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income .....	\$ 4,888	4,603	4,369
Undistributed Earnings of Subsidiaries .....	<u>(2,134)</u>	<u>(2,051)</u>	<u>1,361</u>
Net Cash Provided By Operating Activities	<u>2,754</u>	<u>2,552</u>	<u>5,730</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends Paid.....	(2,652)	(2,552)	(5,739)
Sale (Purchase) of Treasury Stock .....	<u>(98)</u>	<u>0</u>	<u>3</u>
Net Cash Used In Financing Activities	<u>(2,750)</u>	<u>(2,552)</u>	<u>(5,736)</u>
Net (Decrease) Increase in Cash .....	4	0	(6)
Cash at Beginning of Period .....	<u>273</u>	<u>273</u>	<u>279</u>
Cash at End of Period.....	<u>\$ 277</u>	<u>273</u>	<u>273</u>

**(23) 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 7, 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.

The following table summarizes the book value and fair value of financial instruments at December 31, 2006 and 2005.

(Dollars in thousands)	December 31, 2006		December 31, 2005	
	Book	Fair	Book	Fair
Financial assets:	<u>Value</u>	<u>Value</u>	<u>Value</u>	<u>Value</u>
Cash and due from banks.....	\$ 9,498	9,498	6,350	6,350
Interest-bearing balances.....	46,921	46,921	54,549	54,549
Investment securities.....	57,261	57,261	50,878	50,878
Net loans.....	354,386	355,155	308,133	306,157
(Dollars in thousands)				
Financial liabilities:	<u>Value</u>	<u>Value</u>	<u>Value</u>	<u>Value</u>
Deposits.....	\$ 364,226	364,110	325,274	324,461
Short-term borrowings.....	24,275	24,275	12,342	12,342
Accrued interest.....	1,912	1,912	1,535	1,535
Long-term debt.....	59,713	60,042	59,838	59,829
Off-balance sheet financial instruments:				
Commitments to extend credit.....	\$ 75,051	75,051	64,795	64,795
Financial standby letters of credit.....	11,163	11,163	10,102	10,102

**(24) 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.

In September of 2005, Mid Penn Bancorp's Board of Directors approved a Stock Repurchase Program under which the Corporation could buy back up to 250,000 shares of Mid Penn Bancorp Common Stock. Through December 31, 2006, 3,982 shares have been repurchased at an average price of \$24.55 per share.

**(25) Summary of Quarterly Consolidated Financial Data (Unaudited)**

The following table presents summarized quarterly financial data for 2006, 2005 and 2004.

(Dollars in Thousands, Except Per Share Data)

		2006 Quarter Ended			
		Mar. 31	June 30	Sept. 30	Dec. 31
Interest Income .....	\$	6,580	6,962	7,104	7,568
Interest Expense .....		<u>2,807</u>	<u>3,071</u>	<u>3,290</u>	<u>3,564</u>
Net Interest Income .....		3,773	3,891	3,814	4,004
Provision for Loan Losses .....		<u>135</u>	<u>225</u>	<u>75</u>	<u>300</u>
Net Interest Income After Provision for Loan Losses .....		3,638	3,666	3,739	3,704
Other Income .....		673	741	723	754
Securities Gains .....		0	0	33	0
Gain (Loss) on Sale of Other Real Estate .....		152	0	(21)	(27)
Other Expenses .....		<u>2,914</u>	<u>2,895</u>	<u>2,785</u>	<u>2,669</u>
Income Before Income Tax Provision .....		1,549	1,512	1,689	1,762
Income Tax Provision .....		<u>394</u>	<u>395</u>	<u>447</u>	<u>388</u>
Net Income .....	\$	<u>1,155</u>	<u>1,117</u>	<u>1,242</u>	<u>1,374</u>
Earnings Per Share .....	\$	<u>.34</u>	<u>.33</u>	<u>.37</u>	<u>.42</u>

(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 (Credit) for Loan Losses .....		<u>60</u>	<u>110</u>	<u>280</u>	<u>(225)</u>
Net Interest Income After Provision (Credit) 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>



**(26) Subsequent Event**

On February 15, 2007, the Bank settled on a parcel of real estate for approximately \$350,000 which the Bank has purchased for possible future use.

**(27) Recent Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123(R), "Share-Based Payment" ("SFAS 123(R)"). SFAS 123(R) establishes standards for accounting for transactions in which an entity exchanges its equity instruments for goods or services. SFAS 123(R) focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123(R) requires that the fair value of such equity instruments be recognized as expense in the financial statements as services are performed. Prior to SFAS 123(R), only the pro forma disclosures of fair value were required. MPB did not have any share-based payment transactions therefore the adoption of SFAS 123(R) at the beginning of 2006 had no effect on MPB's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"), to establish a consistent framework for measuring fair value and expand disclosures on fair value measurements. The provisions of SFAS No. 157 are effective for fiscal year beginning after December 17, 2007 and are not expected to have a material effect on MPB's consolidated financial statements.

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("Interpretation 48"). Interpretation 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes." Interpretation 48 is effective for fiscal years beginning after December 17, 2007. MPB does not expect the adoption of this pronouncement to have a material effect on its consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments." SFAS No. 155 permits fair value remeasurement for any hybrid financial instruments that contain an embedded derivative that otherwise would require bifurcation. As of December 31, 2006, MPB did not have any hybrid financial instruments subject to the fair value election under SFAS No. 155. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 2006.

SFAS No. 156, Accounting for Servicing of Financial Assets - an amendment of SFAS No. 140 requires that all separately recognized servicing assets and liabilities be initially measured at fair value and permits (but does not require) subsequent measurement of servicing assets and liabilities at fair value. This statement is effective for fiscal years beginning after September 15, 2006. MPB has evaluated this statement and does not believe it will have a material effect on MPB's consolidated financial statements.

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 \$4,888,000 for the year 2006, compared to \$4,603,000 in 2005, which was an increase of \$285,000 or 6.2%. This represents net income in 2006 of \$1.46 per share compared to \$1.37 per share in 2005 and \$1.30 per share in 2004.

Total assets of MPB continued to grow in 2006, reaching the level of \$491,694,000, an increase of \$53,584,000 or 12.2% over \$438,110,000 at year end 2005. 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 12.93% in 2006, 12.87% in 2005 and 12.73% in 2004. Return on average assets (ROA), another performance indicator, was 1.08% in 2006, 1.10% in 2005 and 1.12% in 2004.

The Bank's tier one capital (to risk weighted assets) of \$36,833,000 or 9.4% and total capital (to risk weighted assets) of \$41,020,000 or 10.5% at December 31, 2006, 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.

In early December, MPB completed the purchase of two Dauphin County branches of Omega Bank located at 51 South Front Street in Steelton and 1100 Spring Garden Drive in Middletown. This acquisition includes approximately \$27 million in deposits and \$16 million in loans and is expected to contribute positively to earnings in 2007. Steelton and Middletown are an excellent geographic fit for Mid Penn and for expanding our presence in Dauphin County, including further south into a market with attractive growth characteristics.

### **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 and lease portfolio and the material effect that such judgments 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 2006 net interest income increased \$1,745,000 or 12.7% as compared to an increase of \$1,665,000 or 13.8% in 2005. The average balances, effective interest differential and interest yields for the years ended December 31, 2006, 2005 and 2004 and the components of net interest income, are presented in Table 1. A comparative presentation of the changes in net interest income for 2006 compared to 2005, and 2005 compared to 2004, 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 6.80% in 2006 from 6.10% in 2005. The yield on earning assets for 2004 was 5.66%. 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 2006 was 7.96% as compared to 6.19% for 2005 and 4.34% for 2004.

Interest expense increased by \$3,175,000 or 33.22% in 2006 as compared to \$1,552,000 or 19.39% in 2005.

Primarily resulting from the fluctuations in interest rates, the net interest margin, on a tax equivalent basis, in 2006 was 3.82% compared to 3.67% in 2005 and 3.48% in 2004. 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, 2006

(Dollars in thousands)	Average Balance	Interest Income/Expense	Average Rates Earned/Paid
<b>ASSETS:</b>			
Interest Bearing Balances .....	\$ 46,038	\$ 2,225	4.83%
Investment Securities:			
Taxable .....	27,343	1,218	4.45%
Tax-Exempt .....	<u>28,402</u>	1,950	6.87%
Total Investment Securities	<u>55,745</u>		
Federal Funds Sold .....	564	29	5.14%
Loans, Net .....	<u>324,720</u>	<u>23,598</u>	7.27%
Total Earning Assets .....	427,067	<u>29,020</u>	6.80%
Cash and Due from Banks .....	7,000		
Other Assets .....	<u>19,100</u>		
Total Assets	\$ <u>453,167</u>		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY:</b>			
Interest Bearing Deposits:			
NOW .....	\$ 31,877	90	0.28%
Money Market .....	60,968	1,898	3.11%
Savings .....	24,772	61	0.25%
Time .....	172,792	6,819	3.95%
Short-term Borrowings .....	14,937	686	4.59%
Long-term Debt .....	<u>63,329</u>	<u>3,178</u>	5.02%
Total Interest Bearing Liabilities .....	368,675	<u>12,732</u>	3.45%
Demand Deposits .....	43,161		
Other Liabilities .....	3,527		
Stockholders' Equity .....	<u>37,804</u>		
Total Liabilities and Stockholders' Equity	\$ <u>453,167</u>		
Net Interest Income .....		\$ <u>16,288</u>	
Net Yield on Interest Earning Assets:			
Total Yield on Earning Assets .....			6.80%
Rate on Supporting Liabilities .....			2.98%
Net Interest Margin .....			3.82%
Average Interest Spread .....			3.35%

**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, 2005

(Dollars in thousands)	Average <u>Balance</u>	Interest <u>Income/Expense</u>	Average Rates <u>Earned/Paid</u>
ASSETS:			
Interest Bearing Balances .....	\$ 58,735	\$ 2,067	3.52%
Investment Securities:			
Taxable .....	23,081	893	3.87%
Tax-Exempt .....	<u>22,866</u>	1,561	6.83%
Total Investment Securities	<u>45,947</u>		
Federal Funds Sold .....	1,623	53	3.27%
Loans, Net .....	<u>287,185</u>	<u>19,427</u>	6.76%
Total Earning Assets .....	393,490	<u>24,001</u>	6.10%
Cash and Due from Banks .....	6,940		
Other Assets .....	<u>18,218</u>		
Total Assets	\$ <u>418,648</u>		
LIABILITIES & STOCKHOLDERS' EQUITY:			
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 .....	<u>59,021</u>	<u>2,833</u>	4.80%
Total Interest Bearing Liabilities .....	337,053	<u>9,557</u>	2.84%
Demand Deposits .....	41,484		
Other Liabilities .....	4,332		
Stockholders' Equity .....	<u>35,779</u>		
Total Liabilities and Stockholders' Equity	\$ <u>418,648</u>		
Net Interest Income .....		\$ <u>14,444</u>	
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 .....	26,555	1,948	7.34%
Total Investment Securities	<u>44,086</u>		
Federal Funds Sold .....	346	7	2.02%
Loans, Net .....	256,627	16,449	6.41%
Total Earning Assets .....	367,809	<u>20,812</u>	5.66%
Cash and Due from Banks .....	6,527		
Other Assets .....	16,002		
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 .....	43,780	2,244	5.13%
Total Interest Bearing Liabilities .....	317,274	<u>8,005</u>	2.52%
Demand Deposits .....	37,586		
Other Liabilities .....	1,951		
Stockholders' Equity .....	<u>33,527</u>		
Total Liabilities and Stockholders' Equity	\$ <u>390,338</u>		
Net Interest Income .....		\$ <u>12,807</u>	
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%

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 \$748,000, \$492,000 and \$448,000 are included with interest income in Table 1 for the years 2006, 2005 and 2004, respectively.

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

(Dollars in thousands)

	2006 Compared to 2005			2005 Compared to 2004		
	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 .....	\$ (447)	605	158	(217)	475	258
Investment Securities:						
Taxable .....	165	160	325	190	104	294
Tax-Exempt .....	378	11	389	(271)	(116)	(387)
Total Investment Securities	543	171	714	(81)	(12)	(93)
Federal Funds Sold .....	(35)	11	(24)	26	20	46
Loans, Net .....	2,537	1,634	4,171	1,959	1,019	2,978
Total Interest Income	2,598	2,421	5,019	1,687	1,502	3,189
<b>INTEREST EXPENSE:</b>						
Interest Bearing Deposits:						
NOW .....	(1)	33	32	(3)	0	(3)
Money Market .....	212	613	825	56	575	631
Savings .....	(8)	0	(8)	(2)	(6)	(8)
Time .....	464	1,034	1,498	192	85	277
Total Interest Bearing Deposits	667	1,680	2,347	243	654	897
Short-term Borrowings .....	202	281	483	(47)	113	66
Long-term Debt .....	207	138	345	782	(193)	589
Total Interest Expense	1,076	2,099	3,175	978	574	1,552
NET INTEREST INCOME .....	\$ 1,522	322	1,844	709	928	1,637

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 \$735,000 provision in 2006 as well as a provision of \$225,000 in 2005 and \$725,000 in 2004. The allowance for loan and lease losses as a percentage of total loans was 1.17% at December 31, 2006, compared to 1.18% at December 31, 2005 and 1.30% at December 31, 2004, 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 2005 allowed the Bank to reduce its 2005 provision to \$225,000. The loans purchased through the Omega merger approximately \$16 million in total, were recorded in December 2006 at fair value with no related allowance for loan losses. Thus, these loans were not included in the adequacy model in December of 2006. 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,				
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Balance, beginning of year.....	\$ 3,704	3,643	2,992	3,051	2,856
Loans charged-off:					
Commercial real estate, construction and land development .....	17	32	25	171	41
Commercial, industrial and agricultural.....	158	29	10	140	113
Real estate-residential .....	0	0	8	0	0
Consumer .....	134	138	78	98	148
Total loans charged off	<u>309</u>	<u>199</u>	<u>121</u>	<u>409</u>	<u>302</u>
Recoveries on loans previously charged-off:					
Commercial real estate, construction and land development .....	0	0	0	0	17
Commercial, industrial and agricultural.....	3	12	8	14	0
Real estate-residential .....	0	0	0	0	0
Consumer .....	54	23	39	46	55
Total recoveries	<u>57</u>	<u>35</u>	<u>47</u>	<u>60</u>	<u>72</u>
Net charge-offs.....	<u>252</u>	<u>164</u>	<u>74</u>	<u>349</u>	<u>230</u>
Provision for loan and lease losses .....	<u>735</u>	<u>225</u>	<u>725</u>	<u>290</u>	<u>425</u>
Balance, end of year.....	\$ <u>4,187</u>	<u>3,704</u>	<u>3,643</u>	<u>2,992</u>	<u>3,051</u>
Ratio of net charge-offs during the year to average loans outstanding during the year, net of unearned discount.....	<u>.08%</u>	<u>.06%</u>	<u>.03%</u>	<u>.14%</u>	<u>.11%</u>
Allowance for loan losses as a percentage of total loans .....	<u>1.17%</u>	<u>1.18%</u>	<u>1.30%</u>	<u>1.28%</u>	<u>1.37%</u>

**Noninterest Income**

During 2006, MPB earned \$3,028,000 in noninterest income, compared to \$2,953,000 earned in 2005 and \$3,457,000 earned in 2004.

Service charges on deposit accounts amounted to \$1,376,000 for 2006, an increase of \$28,000 or 2.1% compared to \$1,348,000 for 2005, which was a decrease of \$119,000 or 8.1% under 2004. 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.

Investment security gains of \$33,000 were realized in 2006. 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 of life insurance policies that informally provide funding for director retirement and salary continuation and deferred compensation plans. The income on these policies amounted to \$219,000 during the year 2006, \$222,000 in 2005 and \$211,000 in 2004.

Trust department income for 2006 was \$258,000, a \$54,000 or 17.3% decrease from \$312,000 in 2005, which was a \$64,000 or 25.8% increase from the \$248,000 in 2004. Trust Department income can fluctuate from year to year, due to the number of estates being settled during the year.

MPB also earned \$112,000 in 2006, \$70,000 in 2005 and \$162,000 in 2004 in fees from the third-party seller of investments whose services the Bank has contracted. The decrease in investment services income during 2005 resulted from a vacancy in the investment representative position for more than six months. Other income amounted to \$655,000 in 2006, \$702,000 in 2005 and \$725,000 in 2004.

**Noninterest Expense**

A summary of the major components of noninterest expense for the years ended December 31, 2006, 2005 and 2004 is reflected in Table 4. Noninterest expense increased to \$11,263,000 in 2006 from \$10,262,000 in 2005 and \$9,030,000 in 2004. The major component of noninterest expense is salaries and employee benefits. The number of full-time equivalent employees increased from 124 to 133 during 2006. Increases in the 2006 workforce included the purchase and addition of two Omega Bank branches. Early withdrawal penalties on investment CDs of \$191,000 and recruiter fees of \$94,000 contributed to the increase in noninterest expense. Another significant expense in 2006 was the continuing 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,		
	2006	2005	2004
Salaries and employee benefits .....	\$ 6,023	5,662	4,918
Occupancy, net .....	622	594	456
Equipment .....	838	734	631
Postage and supplies .....	370	370	308
Marketing and advertising .....	255	298	185
Other real estate, net .....	146	91	0
Pennsylvania bank shares tax .....	286	259	265
Telephone .....	85	91	86
Loss on mortgage sales .....	51	51	66
Legal and professional services .....	733	590	505
Debit card processing .....	129	154	214
Director fees and benefits .....	241	221	196
Computer software licensing and maintenance .....	208	179	170
Early withdrawal penalty on investment CD's .....	191	0	0
Other .....	1,085	968	1,030
Total Noninterest Expense	\$ <u>11,263</u>	<u>10,262</u>	<u>9,030</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, 2006, SFAS No. 115 resulted in a contribution to shareholders' equity of \$291,000 (unrealized gain on securities of \$441,000 less estimated income tax expense of \$150,000). At December 31, 2005, SFAS No. 115 resulted in an increase in the unrealized gain included in other comprehensive income of \$231,000 (unrealized gain on securities of \$352,000 less estimated income tax expense of \$121,000) compared to a December 31, 2004 increase in the unrealized gain included in other comprehensive income of \$693,000 (unrealized gain on securities of \$1,051,000, less estimated income tax expense of \$357,000).

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**

(Dollars in thousands)	December 31,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
U. S. Treasury and U.S. government agencies .....	\$ 15,015	14,999	11,998
Mortgage-backed U.S. government agencies.....	9,041	8,112	5,508
State and political subdivision obligations .....	29,050	24,162	22,620
Restricted equity securities.....	<u>3,713</u>	<u>3,253</u>	<u>3,435</u>
Total	<u>\$ 56,819</u>	<u>50,526</u>	<u>43,561</u>

**Loans**

At December 31, 2006, net loans totaled \$354,386,000, a \$46,253,000 or 15.0% increase from December 31, 2005. During 2006, MPB experienced a net increase in commercial real estate and commercial/industrial loans of approximately \$24,695,000, the majority of which was generated in the greater Capital (Harrisburg) Region. Approximately \$16 million of this growth came from the purchase of the Omega Branches.

The current environment in lending remains extremely competitive with financial institutions aggressively pursuing potential borrowers. At December 31, 2006, loans, net of unearned income, represented 76.1% of earning assets as compared to 73.7% on December 31, 2005 and 71.5% on December 31, 2004.

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 Hampden Township in 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**

(Dollars in thousands)	December 31,									
	<u>2006</u>		<u>2005</u>		<u>2004</u>		<u>2003</u>		<u>2002</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 .....	\$ 226,663	63.0%	219,385	70.0%	195,549	69.6%	154,296	66.5%	146,325	65.6%
Commercial, industrial and agricultural .....	48,785	13.5	31,368	10.0	30,940	11.0	25,567	11.0	22,398	10.0
Real estate-residential.....	63,141	17.5	44,688	14.3	43,914	15.6	43,384	18.7	41,502	18.6
Consumer .....	<u>21,747</u>	<u>6.0</u>	<u>17,982</u>	<u>5.7</u>	<u>10,680</u>	<u>3.8</u>	<u>10,380</u>	<u>3.8</u>	<u>12,978</u>	<u>5.8</u>
Total Loans	<u>360,336</u>	<u>100</u>	<u>313,423</u>	<u>100</u>	<u>281,083</u>	<u>100</u>	<u>233,627</u>	<u>100</u>	<u>233,203</u>	<u>100</u>
Unearned income.....	<u>(1,763)</u>		<u>(1,586)</u>		<u>(1,536)</u>		<u>(1,549)</u>		<u>(1,850)</u>	
Loans net of unearned discount.....	358,573		311,837		279,547		232,078		221,353	
Allowance for loan and lease losses .....	<u>(4,187)</u>		<u>(3,704)</u>		<u>(3,643)</u>		<u>(2,992)</u>		<u>(3,051)</u>	
Net Loans	<u>\$ 354,386</u>		<u>308,133</u>		<u>275,904</u>		<u>229,086</u>		<u>218,302</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 lending conditions, management trends and other factors.

The 2006 provision of \$735,000 reflects both an increase in net loan losses in 2006 and loan growth. It is comparable to the 2004 provision. The 2005 provision of \$225,000 reflected the removal from the "watch list" of a significant loan relationship, thus reducing overall provisions in 2005.

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, 2006 was \$4,187,000 or 1.17% of total loans less unearned discount as compared to \$3,704,000 or 1.19% at December 31, 2005 and \$3,643,000 or 1.30% at December 31, 2004.

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

(Dollars in thousands)		<u>2006</u>	<u>2005</u>	December 31,		
				<u>2004</u>	<u>2003</u>	<u>2002</u>
Commercial real estate, construction and land development.....	\$	2,462	2,037	2,368	1,938	1,898
Commercial, industrial and agricultural .....		1,515	1,481	1,093	954	922
Real estate-residential .....		54	52	65	20	56
Consumer .....		124	110	83	65	147
General .....		<u>32</u>	<u>24</u>	<u>34</u>	<u>15</u>	<u>28</u>
Total Loans	\$	<u>4,187</u>	<u>3,704</u>	<u>3,643</u>	<u>2,992</u>	<u>3,051</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 \$586,000, \$892,000 and \$397,000 in 2006, 2005 and 2004, 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, 2006, totaled \$2,434,000 or 0.50% of total assets compared to \$3,317,000 or 0.76% of total assets in 2005 and \$1,775,000 or 0.44% of total assets in 2004. The foreclosed assets held for sale at December 31, 2006, consist of two parcels of commercial real estate and one residential property.

**TABLE 8: NONPERFORMING ASSETS**

(Dollars in thousands)	December 31,				
	2006	2005	2004	2003	2002
Nonaccrual loans.....	\$ 1,293	1,773	873	984	1,164
Past due 90 days or more .....	995	1,086	397	666	808
Restructured loans.....	0	0	0	0	0
Total nonperforming loans	2,288	2,859	1,270	1,650	1,972
Foreclosed assets held for sale .....	146	458	505	1,117	781
Total nonperforming assets	\$ 2,434	3,317	1,775	2,767	2,753
Percent of loans outstanding.....	0.68%	1.06%	0.63%	1.18%	1.23%
Percent of total assets.....	0.50%	0.76%	0.44%	0.74%	0.76%

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, 2006 increased by \$38,952,000 or 12.0% over December 31, 2005, which increased by \$24,130,000 or 8.0% over December 31, 2004. Average balances and average interest rates applicable to the major classifications of deposits for the years ended December 31, 2006, 2005, and 2004 are presented in Table 9. Approximately \$27 million of 2006 deposit growth was related to the purchase of two Omega Bank offices in Steelton and Middletown.

Average short-term borrowings for 2006 were \$14,937,000 as compared to \$7,498,000 in 2005. These borrowings included customer repurchase agreements, treasury tax and loan option borrowings and federal funds purchased. Two five-million dollar borrowings, maturing March 2009 and February 2011, were entered into during 2006 with the FHLB.

**TABLE 9: DEPOSITS BY MAJOR CLASSIFICATION**

(Dollars in thousands)	Years ended December 31,					
	2006		2005		2004	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing demand deposits.....	\$ 43,161	0.00%	41,484	0.00%	38,884	0.00%
Interest-bearing demand deposits .....	31,877	0.28%	32,507	0.18%	34,750	0.18%
Money market.....	60,968	3.11%	50,913	2.11%	45,202	0.98%
Savings.....	24,772	0.25%	28,179	0.24%	29,027	0.27%
Time .....	172,792	3.95%	158,935	3.35%	153,100	3.29%
Total	\$ 333,570	2.66%	312,018	2.09%	300,963	1.88%

### **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.

Capital growth is achieved by retaining more in earnings than is paid out to our shareholders. Stockholders' equity increased in 2006 by \$2,224,000 or 6.0% and by \$1,589,000 or 4.5% in 2005. 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.

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 54% for 2006 compared to 55% for 2005 and 131% for 2004.

At December 31, 2006, 23,038 shares of MPB's common stock have been purchased back by MPB, held as treasury stock.

### **Federal Income Taxes**

Federal income tax expense for 2006 was \$1,624,000 compared to \$1,600,000 and \$1,405,000 in 2005 and 2004, respectively. The effective tax rate was 25% for 2006, 26% for 2005 and 24% for 2004.

### **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 investments 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 2006 came from operations and a net increase in deposits of \$11,795,000 (excluding the deposits of the purchased Omega offices), as well as an increase in short-term borrowings of \$11,933,000. Other major sources of funds included a net decrease in interest-bearing balances (investment certificates of deposit of other banks), as well as the cash received of \$7,100,000 through the Omega Branches purchase.

The major use of cash in 2006 was funding strong loan demand. Net loans increased \$46,253,000, including \$16,307,000 in loans received as part of the Omega Branch acquisition. Another major use of funds was an increase in investment securities of \$6,383,000, as funds were moved out of lower yielding interest-bearing balances.

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.

### **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, 2006				Total
		One Year and Less	After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	
U.S. Treasury and U.S. government agencies .....	\$	1,996	7,442	4,905	493	14,836
State and political subdivision obligations .....		456	3,260	12,717	13,314	29,747
Mortgage-backed U.S. government agencies .....		0	0	42	8,932	8,974
Equity securities .....		0	0	0	3,704	3,704
Total	\$	<u>2,452</u>	<u>10,702</u>	<u>17,664</u>	<u>26,443</u>	<u>57,261</u>

		One Year and Less	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 .....		4.54	4.27	4.18	5.00	4.28
State and political subdivision obligations .....		6.03	7.05	6.89	6.34	6.66
Mortgage-backed U.S. government agencies .....		0	0	6.51	4.94	4.95
Equity securities .....		0	0	0	4.77	4.77
Total		<u>4.82</u>	<u>5.10</u>	<u>6.10</u>	<u>5.63</u>	<u>5.64</u>

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

(Dollars in thousands)

		December 31, 2006			
		One Year and Less	After One Year thru Five Years	After Five Years	Total
Commercial, real estate, construction and land development .....	\$	62,982	120,929	42,752	226,663
Commercial, industrial and agricultural .....		21,936	18,575	8,274	48,785
Real estate-residential mortgages .....		18,850	29,432	14,859	63,141
Consumer .....		5,581	10,943	5,223	21,747
Total Loans	\$	<u>109,349</u>	<u>179,879</u>	<u>71,108</u>	<u>360,336</u>

		One Year and Less	After One Year thru Five Years	After Five Years	Total
<u>Rate Sensitivity</u>					
Predetermined rate .....	\$	18,483	48,166	68,238	134,887
Floating or adjustable rate .....		90,866	131,713	2,870	225,449
Total	\$	<u>109,349</u>	<u>179,879</u>	<u>71,108</u>	<u>360,336</u>

**TABLE 12: INTEREST RATE SENSITIVITY GAP**

(Dollars in thousands)

(As of December 31, 2006)

		Expected Maturity							Fair Value
		2007	2008	2009	2010	2011	Thereafter	Total	
Assets:									
Interest bearing balances .....	\$	31,197	9,788	4,748	297	891	0	46,921	46,921
Average interest rate .....		5.41	5.39	5.39	5.35	5.67	-	5.41	
Debt securities .....		2,451	3,869	2,719	2,592	1,522	44,108	57,261	57,261
Average interest rate .....		4.47	4.38	4.58	6.15	6.10	5.63	5.64	
Adjustable rate loans .....		90,866	31,003	38,069	34,321	28,320	2,870	225,449	225,449
Average interest rate .....		8.19	6.26	6.50	6.50	7.13	6.03	7.22	
Fixed rate loans .....		18,483	8,660	15,743	7,835	15,928	68,238	134,887	135,656
Average interest rate .....		7.15	6.50	6.70	7.04	6.82	6.90	6.88	
Total	\$	<u>142,997</u>	<u>53,320</u>	<u>61,279</u>	<u>45,045</u>	<u>46,661</u>	<u>115,216</u>	<u>464,518</u>	<u>465,287</u>

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

## Interest liabilities:

Variable rate savings and transaction accounts .....	\$	74,236	0	0	0	0	87,876	162,112	162,599
Average interest rate .....		2.81	-	-	-	-	0.10	1.34	
Certificates of deposit and IRAs .....		102,971	42,810	18,464	18,378	16,326	3,165	202,114	201,997
Average interest rate .....		4.18	4.48	3.92	4.27	5.22	4.14	4.33	
Short term borrowings .....		24,275	0	0	0	0	0	24,275	24,275
Average interest rate .....		4.91	-	-	-	-	-	4.91	
Long term fixed rate borrowings .....		5,131	15,138	12,145	10,152	5,159	11,988	59,713	60,042
Average interest rate .....		3.71%	3.56	4.64	6.50	5.13	4.61	4.69	
Total	\$	<u>206,613</u>	<u>57,948</u>	<u>30,609</u>	<u>28,530</u>	<u>21,485</u>	<u>103,029</u>	<u>448,214</u>	<u>448,913</u>

## Rate sensitive gap:

Periodic gap .....	\$	(63,616)	(4,628)	30,670	16,515	25,176	12,187		
Cumulative gap .....	\$	(63,616)	(68,244)	(37,574)	(21,059)	4,117	16,304		
Cumulative gap as a percentage of total assets .....		-12.9%	-13.9%	-7.6%	-4.3%	+0.8%	+3.3%		

(Dollars in thousands)

(As of December 31, 2005)

		Expected Maturity						Total	Fair Value
		Year Ended December 31,							
		2006	2007	2008	2009	2010	Thereafter		
Assets:									
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	
Total	\$	<u>145,135</u>	<u>32,817</u>	<u>60,498</u>	<u>45,570</u>	<u>43,559</u>	<u>90,919</u>	<u>418,498</u>	<u>416,874</u>

(Dollars in thousands)

(As of December 31, 2005)

		Expected Maturity						Total	Fair Value
		Year Ended December 31,							
		2006	2007	2008	2009	2010	Thereafter		
Interest liabilities:									
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	
Total	\$	<u>166,935</u>	<u>53,095</u>	<u>33,438</u>	<u>27,494</u>	<u>20,728</u>	<u>95,764</u>	<u>397,454</u>	<u>396,181</u>

## Rate sensitive gap:

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		
Cumulative gap as a percentage of total assets .....		-5.0%	-9.6%	-3.4%	+0.7%	+5.9%	+4.8%		

During 2006, 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, 2006, 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,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Three months or less.....	\$ 675	8,421	7,431
Over three months to twelve months.....	11,300	12,930	6,771
Over twelve months.....	<u>22,010</u>	<u>12,868</u>	<u>13,681</u>
Total	\$ <u>33,985</u>	<u>34,219</u>	<u>27,883</u>

### **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, 2006, commitments to extend credit amounted to \$70,630,000 as compared to \$64,795,000 as of December 31, 2005.

MPB also issues financial standby letters of credit to its customers. The risk associated with financial standby letters of credit is essentially the same as the credit risk involved in loan extensions to customers. Financial standby letters of credit increased to \$11,163,000 at December 31, 2006, from \$10,102,000 at December 31, 2005.

### **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 primarily of unrealized gains and losses on available-for-sale securities, net of deferred income tax. Other Comprehensive Income also includes a pension component in accordance with FASB Statement No. 158. Comprehensive Income should not be construed to be a measure of net income. The effect of Other Comprehensive Income would only be reflected in the income statement if the entire portfolio of available-for-sale securities were sold on the statement date. The amount of unrealized gains or losses reflected in Comprehensive Income may vary widely at statement dates depending on the markets as a whole and how the portfolio of available-for-sale securities is affected by interest rate movements. Other Comprehensive Income (Loss) for the years ended December 31, 2006, 2005 and 2004 was \$86,000, \$(462,000) and \$(722,000), respectively.

**Summary of Selected Financial Data**

(Dollars in thousands, except per share data)

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
INCOME:					
Total Interest Income.....	\$ 28,214	23,294	20,077	19,984	21,352
Total Interest Expense .....	12,732	9,557	8,005	8,434	9,926
Net Interest Income .....	15,482	13,737	12,072	11,550	11,426
Provision for Possible Loan and Lease Losses.....	735	225	725	290	425
Noninterest Income.....	3,028	2,953	3,457	2,707	2,022
Noninterest Expense .....	11,263	10,262	9,030	8,099	7,258
Income Before Income Taxes .....	6,512	6,203	5,774	5,868	5,765
Provision for Income Taxes .....	1,624	1,600	1,405	1,253	1,270
Net Income .....	4,888	4,603	4,369	4,615	4,495
COMMON STOCK DATA PER SHARE:					
Earnings Per Share .....	\$ 1.46	1.37	1.30	1.38	1.34
Cash Dividends Declared, historical.....	.80	.80	1.80	.80	.80
Stockholders' Equity .....	11.68	11.01	10.53	11.16	10.51
AVERAGE SHARES OUTSTANDING.....	3,346,102	3,348,299	3,348,310	3,347,929	3,347,750
AT YEAR-END:					
Investments .....	\$ 46,921	54,549	44,613	54,093	58,859
Loans, Net of Unearned Discount.....	358,612	311,837	279,547	232,078	221,353
Allowance for Loan Losses .....	4,187	3,704	3,643	2,992	3,051
Total Assets .....	491,694	438,110	403,256	373,466	363,284
Total Deposits .....	364,226	325,274	301,144	288,338	274,703
Short-term Borrowings.....	24,275	12,342	13,801	9,688	18,156
Long-term Debt .....	59,713	59,838	49,957	35,684	32,383
Stockholders' Equity .....	\$ 39,085	36,861	35,272	37,361	35,204
RATIOS:					
Return on Average Assets.....	% 1.08	1.10	1.12	1.25	1.32
Return on Average Stockholders' Equity.....	12.93	12.87	12.73	12.69	13.60
Cash Dividend Payout Ratio .....	54.79	55.56	131.38	54.48	54.05
Allowance for Loan Losses to Loans.....	1.17	1.19	1.30	1.29	1.38
Average Stockholders' Equity to Average Assets .....	8.34	8.55	8.75	9.97	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

**Robert C. Grubic**

President & CEO  
Herbert, Rowland and Grubic, Inc.

**Gregory M. Kerwin**

Senior Partner  
Kerwin & Kerwin, Attorneys

**Theodore W. Mowery**

Partner  
Gunn-Mowery Insurance  
Group, Inc.

**Donald E. Sauve**

Consultant  
Don's Food Market, Inc.

**Edwin D. Schlegel**

Retired Superintendent  
Millersburg Area School District

**Guy J. Snyder, Jr.**

President  
Snyder Fuels, Inc.

**William A. Specht, III**

President  
Seal Glove Mfg, Inc.

**DIRECTORS EMERITI****Earl R. Etzweiler****Harvey J. Hummel****Charles F. Lebo****Warren A. Miller****William G. Nelson****Eugene F. Shaffer****Anna C. Woodside****EXECUTIVE OFFICERS****Mid Penn Bancorp, Inc.****Alan W. Dakey**

Chairman, President and CEO

**Edwin D. Schlegel**

Vice Chairman and Lead Director

**Kevin W. Laudenslager**

Treasurer

**Cindy L. Wetzel**

Secretary

**SENIOR MANAGEMENT****Mid Penn Bank****Alan W. Dakey**

Chairman, President and CEO  
*33 Years Banking Experience*

**Kevin W. Laudenslager**

Executive Vice President and Chief  
Financial Officer  
*22 Years Banking Experience*

**Eric S. Williams**

Executive Vice President and  
Senior Commercial Loan Officer  
*28 Years Banking Experience*

**Randall L. Klinger**

Senior Vice President  
and Senior Credit Officer  
*33 Years Banking Experience*

**Leonard K. Beasom, Jr.**

Vice President and Commercial Loan Officer  
*35 Years Banking Experience*

**Donald J. Bonafede**

Vice President and  
Director of Equipment Leasing  
*24 Years Banking Experience*

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Vice President and Marketing Director  
*22 Years Banking Experience*

**Roberta A. Hoffman, PHR**

Vice President, Human Resources  
Officer and Asst. Secretary  
*31 Years Banking Experience*

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Vice President and Chief Information Officer  
*26 Years Banking Experience*

**Michael T. Lehmer**

Vice President and Senior Trust Officer  
*16 Years Banking Experience*

**John F. Lydic**

Vice President and Retail Division Manager  
*25 Years Banking Experience*

**Robert E. McDonald**

Vice President and Commercial Lending Team Leader  
*23 Years Banking Experience*

**Eric D. Mummau**

Vice President and Commercial Loan Officer  
*27 Years Banking Experience*

**Brad N. Shaak**

Vice President, Consumer and Mortgage Lending Manager  
*20 Years Banking Experience*

**Steven S. Shuey**

Vice President and Loan Review Officer  
*33 Years Banking Experience*

**Dennis E. Spotts**

Vice President and Operations Officer  
*34 Years Banking Experience*

**Cindy L. Wetzel**

Vice President and Corporate Secretary  
*28 Years Banking Experience*

**Rick E. Witwer**

Vice President and Commercial Loan Officer  
*19 Years Banking Experience*

**ADVISORY BOARD MEMBERS**

**Mid Penn Bank**

**Capital Region:**

**Stanford D. Custer, Jr.**

Custer Homes, Inc.

**Robert C. Grubic**

Herbert, Rowland & Grubic

**Norman L. Houser**

Retired, Mid Penn Bank

**Theodore W. Mowery**

Gun-Mowery Insurance

**Michael G. Musser II**

Steelton Borough Secretary/Treasurer

**Robert M. Newbury**

RM Newbury & Co

**Dale R. Schwan**

Environmental Interiors, Inc.

**Northern Region**

**Matthew G. DeSoto**

MI Windows and Doors

**James S. Facinelli**

Restorations Unlimited, Inc.

**Linda J. Faust**

Faust Real Estate

**Dane P. Harman**

Harman Stove Co.

**Robert E. Klinger**

Klinger Lumber Co, Inc.

**Dixie L. Laudenslager**

Mahantongo Game Farms

**Dr. David R. Russell**

Dr. David R. Russell, DMD, PC

**Kent S. Smeltz**

Advanced Scientifics, Inc.

**Carl E. Snyder**

Century 21- Carl Snyder

**Thomas E. Troutman**

Keystone Insurers Group

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**Harrisburg**

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**Harrisburg**

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