CNB FINANCIAL CORP/PA
Form 10-Q
November 09, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2007

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______

Commission File Number 0-13396

CNB FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Pennsylvania	**25-1450605**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1 South Second Street

P.O. Box 42

Clearfield, Pennsylvania 16830

(Address of principal executive offices)

Registrant s telephone number, including area code, (814) 765-9621

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). ¨ Yes x No

The number of shares outstanding of the issuer s common stock as of November 6, 2007

COMMON STOCK: $0 PAR VALUE, 8,544,399 SHARES

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PART I.

FINANCIAL INFORMATION

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CONSOLIDATED BALANCE SHEETS

CNB FINANCIAL CORPORATION

(Dollars in thousands)

	(unaudited) September 30, 2007	December 31 2006
ASSETS		
Cash and due from banks	$ 14,585	$ 18,530
Interest bearing deposits with other banks	7,150	7,014
Federal funds sold	6,742	7
TOTAL CASH AND CASH EQUIVALENTS	28,477	25,551
Securities available for sale	162,215	156,696
Loans held for sale	1,923	2,420
Loans and leases	589,030	547,946
Less: unearned discount	2,626	926
Less: allowance for loan losses	6,452	6,086
NET LOANS	579,952	540,934
FHLB, and other equity interests	5,468	5,321
Premises and equipment, net	18,054	16,237
Bank owned life insurance	14,960	14,484
Accrued interest receivable and other assets	9,164	7,555
Mortgage servicing rights	450	446
Goodwill	10,821	10,821
Other intangible assets, net	311	385
TOTAL ASSETS	$ 831,795	$ 780,850
LIABILITIES		
Deposits:		
Non-interest bearing deposits	$ 91,450	$ 82,574
Interest bearing deposits	557,954	548,748
TOTAL DEPOSITS	649,404	631,322
Treasury, tax and loan borrowings	2,000	2,000
FHLB and other borrowings	83,000	57,885
Accrued interest and other liabilities	7,280	7,054
Subordinated debentures	20,620	10,310
TOTAL LIABILITIES	762,304	708,571
SHAREHOLDERS EQUITY		
Common stock $0 par value Authorized 50,000,000 shares Issued 9,233,750 shares		
Additional paid in capital	13,057	13,250
Retained earnings	65,642	62,957
Treasury stock, at cost (662,238 shares for September 2007, and 369,546 shares for Dec 2006)	(9,720)	(5,271)
Accumulated other comprehensive income	512	1,343
TOTAL SHAREHOLDERS EQUITY	69,491	72,279

TOTAL LIABILITIES & SHAREHOLDERS EQUITY	$ 831,795	$ 780,850

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CONSOLIDATED STATEMENTS OF INCOME (unaudited)

CNB FINANCIAL CORPORATION

(Dollars in thousands, except per share data)

	THREE MONTHS ENDED SEPTEMBER 30,	
	2007	2006
INTEREST AND DIVIDEND INCOME		
Loans including fees	$ 11,583	$ 10,174
Deposits with banks	116	112
Federal funds sold	90	49
Securities:		
Taxable	1,706	1,459
Tax-exempt	345	412
Dividends	105	149
TOTAL INTEREST AND DIVIDEND INCOME	13,945	12,355
INTEREST EXPENSE		
Deposits	4,592	4,473
Borrowed funds	969	717
Subordinated debentures	356	228
TOTAL INTEREST EXPENSE	5,917	5,418
Net interest income	8,028	6,937
Provision for loan losses	335	324
NET INTEREST INCOME AFTER PROVISION	7,693	6,613
OTHER INCOME		
Trust & asset management fees	312	245
Service charges on deposit accounts	1,117	1,114
Other service charges and fees	216	172
Net security gains	52	2
Mortgage banking income	83	92
Bank owned life insurance earnings	137	187
Wealth management	133	115
Other	33	162
TOTAL OTHER INCOME	2,083	2,089
OTHER EXPENSES		
Salaries & benefits	3,462	2,825
Net occupancy expense of premises	779	705
Amortization of intangibles	25	103
Other	2,177	1,882
TOTAL OTHER EXPENSES	6,443	5,515

Income before income taxes	3,333	3,187
Applicable income taxes	923	844
NET INCOME	$ 2,410	$ 2,343
EARNINGS PER SHARE		
Basic	$ 0.28	$ 0.26
Diluted	$ 0.28	$ 0.26
DIVIDENDS PER SHARE		
Cash dividends per share	$ 0.16	$ 0.14

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CONSOLIDATED STATEMENTS OF INCOME (unaudited)

CNB FINANCIAL CORPORATION

(Dollars in thousands, except per share data)

	NINE MONTHS ENDED SEPTEMBER 30, 2007	2006
INTEREST AND DIVIDEND INCOME		
Loans including fees	$ 32,870	$ 29,580
Deposits with banks	342	322
Federal funds sold	288	266
Securities:		
Taxable	4,837	4,171
Tax-exempt	1,121	1,288
Dividends	312	393
TOTAL INTEREST AND DIVIDEND INCOME	39,770	36,020
INTEREST EXPENSE		
Deposits	13,909	12,433
Borrowed funds	2,404	2,149
Subordinated debentures	959	641
TOTAL INTEREST EXPENSE	17,272	15,223
Net interest income	22,498	20,797
Provision for loan losses	903	1,079
NET INTEREST INCOME AFTER PROVISION	21,595	19,718
OTHER INCOME		
Trust & asset management fees	851	749
Service charges on deposit accounts	3,087	3,108
Other service charges and fees	617	462
Net security gains	87	343
Mortgage banking income	265	327
Bank owned life insurance earnings	476	525
Wealth management	440	388
Other	465	421
TOTAL OTHER INCOME	6,288	6,323
OTHER EXPENSES		
Salaries & benefits	9,606	8,168
Net occupancy expense of premises	2,391	2,107
Amortization of intangibles	75	311
Other	6,658	5,886
TOTAL OTHER EXPENSES	18,730	16,472

Income before income taxes	9,153	9,569
Applicable income taxes	2,439	2,460
NET INCOME	$ 6,714	$ 7,109
EARNINGS PER SHARE, BASED ON WEIGHTED AVERAGE SHARES OUTSTANDING		
Net income, basic	$ 0.77	$ 0.79
Net income, diluted	$ 0.77	$ 0.79
DIVIDENDS PER SHARE		
Cash dividends per share	$ 0.46	$ 0.42

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

CNB FINANCIAL CORPORATION

Consolidated Statements of Comprehensive Income (unaudited)

(dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Net Income	$ 2,410	$ 2,343	$ 6,714	$ 7,109
Other comprehensive income, net of tax				
Unrealized gains/(losses) on securities:				
Unrealized gains/(losses) arising during the period, net of tax of $92 and $(422) for the three months ending September 30, 2007 and 2006 and $416 and $23 for the nine months ending September 30, 2007 and 2006.	(171)	784	(774)	(43)
Reclassification adjustment for accumulated (gains) losses included in net income, net of tax of $18 and $1 for the three months ending September 30, 2007 and 2006 and $30 and $120 for the nine months ending September 30, 2007 and 2006.	(34)	(1)	(57)	(223)
Other comprehensive income (loss)	(205)	783	(831)	(266)
Comprehensive income	$ 2,205	$ 3,126	$ 5,883	$ 6,843

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CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

CNB FINANCIAL CORPORATION

Consolidated Statements of Cash Flows (unaudited)

(Dollars in thousands)

	9 Months Ended September 30, 2007	9 Months Ended September 30, 2006
Cash flows from operating activities:		
Net Income	$ 6,714	$ 7,109
Adjustments to reconcile net income to net cash provided by operations:		
Provision for loan losses	903	1,079
Depreciation and amortization	1,263	1,391
Amortization, accretion and deferred loan fees	(406)	(343)
Deferred taxes	(62)	(106)
Security gains	(87)	(343)
Gain on sale of loans	(188)	(46)
Net (gains) losses on dispositions of acquired property	(59)	
Proceeds from sale of loans	8,546	9,507
Origination of loans held for sale	(8,001)	(10,398)
Increase in bank owned life insurance	(476)	(525)
Stock-based compensation expense	69	46
Changes in:		
Interest receivable and other assets	(1,199)	(281)
Interest payable and other liabilities	741	654
Net cash provided by operating activities	7,758	7,744
Cash flows from investing activities:		
Proceeds from maturities, prepayments and calls of:		
Securities available for sale	33,001	30,766
Proceeds from sales of securities available for sale	3,229	82
Purchase of securities available for sale	(42,955)	(31,574)
Loan origination and payments, net	(40,077)	(27,837)
Redemption (Purchase) of FHLB, FRB & Other Equity Interests	(147)	(203)
Net, purchase of premises and equipment	(2,870)	(1,567)
Proceeds from the sale of premises and equipment and foreclosed assets	220	
Net cash used in investing activities	(49,599)	(30,333)
Cash flows from financing activities:		
Net change in:		
Checking, money market and savings accounts	24,486	(11,297)
Certificates of deposit	(6,404)	17,254
Proceeds from issuance of subordinated debenture	20,620	
Repayments of subordinated debenture	(10,310)	
Treasury stock purchased	(5,616)	(2,016)
Proceeds from sale of treasury stock	817	716
Proceeds from the exercise of stock options	73	
Excess tax benefit from exercise of stock options	15	
Cash dividends paid	(4,029)	(3,768)
Advances from long-term borrowings	40,000	10,000
Repayments of long-term borrowings	(14,885)	(11,250)
Net change in short-term borrowings		2,865

Net cash provided by financing activities	44,767	2,504
Net increase (decrease) in cash and cash equivalents	2,926	(20,085)
Cash and cash equivalents at beginning of year	25,551	43,017
Cash and cash equivalents at end of period	$ 28,477	$ 22,932
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 17,299	$ 15,002
Income Taxes	$ 2,420	$ 2,385
Supplemental non cash disclosures:		
Transfers to other real estate owned	$ 571	$ 142
Grant of restricted stock awards from treasury stock	$ 172	$ 202

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CNB FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission (SEC) and in compliance with U.S. generally accepted accounting principles. Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted.

In the opinion of Management of the registrant, the accompanying consolidated financial statements as of September 30, 2007 and for the quarters and nine months ended September 30, 2007 and 2006 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the periods presented. The financial performance reported for CNB Financial Corporation (the Corporation) for the three and nine month periods ended September 30, 2007 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Corporation s Annual Report to shareholders and Form 10-K for the period ended December 31, 2006.

STOCK COMPENSATION

The Corporation has a stock incentive plan for key employees and independent directors. The Stock incentive plan, which is administered by a committee of the Board of Directors, provides for up to 625,000 shares of common stock in the form of nonqualified options or restricted stock. For key employees, the plan vesting is one-fourth of the granted options or restricted stock per year beginning one year after the grant date with 100% vested on the fourth anniversary of the grant. For independent directors, the vesting schedule is one-third of the granted options per year beginning one year after the grant date with 100% vested on the third anniversary of the grant.

Stock Options

A summary of the activity for stock options is as follows:

	Nine months ended September 30, 2007	
	Total options outstanding	Weighted Average Exercise
	Shares	Price
Options outstanding, beginning of period	267,418	$ 13.15
Forfeited		
Exercised	8,125	9.05
Granted		
Options outstanding, end of period	259,293	$ 13.27
Options exercisable, end of period	259,293	$ 13.27

No stock options were granted during the three or nine month periods ended September 30, 2007 or 2006.

The aggregate intrinsic value of all options outstanding at September 30, 2007 was $527,896. The aggregate intrinsic value of all options that were exercisable at September 30, 2007 was $527,896.

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There was no compensation expense related to stock options for the three or nine months ended September 30, 2007. Compensation expense related to stock options for the nine months ended September 30, 2006 resulted in a reduction of income before taxes of $18,000 and a reduction in net income of $12,000. Due to the insignificance of the amount, there was no measurable effect on basic and diluted earnings per share. There is no remaining unrecognized compensation cost related to unvested stock options granted as of September 30, 2007.

Restricted Stock Awards

Periodically the Executive Compensation and Personnel Committee of the Board of Directors grants restricted stock awards to certain key employees and independent directors of the Corporation. Compensation expense for the restricted stock awards is recognized over the requisite service period noted above based on the fair value of the shares at the date of grant. Unearned restricted stock awards are recorded as a reduction of shareholders equity until earned. Compensation expense resulting from these restricted stock awards was approximately $25,000 and $69,000 for the three and nine months ended September 30, 2007 and $12,000 and $29,000 for the three and nine months ended September 30, 2006. As of September 30, 2007, there was $262,700 of total unrecognized compensation cost related to unvested restricted stock awards. At September 30, 2007, there are 22,690 unvested shares at a weighted average grant date fair value of $14.11.

EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period. Restricted stock awards are considered outstanding as they become earned. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under stock compensation plans. For the three and nine month periods ended September 30, 2007 and 2006, 110,500 shares under option were excluded from the diluted earnings per share calculations as they were anti-dilutive.

The computation of basic and diluted EPS is shown below (in thousands except per share data):

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Basic earnings per share computation:				
Net Income	$ 2,410	$ 2,343	$ 6,714	$ 7,109
Gross weighted average shares outstanding	8,562	8,952	8,742	8,975
Less: Average unearned restricted stock	19	12	19	9
Net weighted average shares outstanding	8,543	8,940	8,723	8,966
Basic earnings per share:	$ 0.28	$ 0.26	$ 0.77	$ 0.79
Diluted earnings per share computation:				
Net Income	$ 2,410	$ 2,343	$ 6,714	$ 7,109
Weighted average shares outstanding for basic earnings per share	8,543	8,940	8,723	8,966
Add: Dilutive effects of assumed exercises of stock options and restricted stock awards	21	24	24	24
Weighted average shares and potentially dilutive shares	8,564	8,964	8,747	8,990
Diluted earnings per share	$ 0.28	$ 0.26	$ 0.77	$ 0.79

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RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* (FIN 48), which prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have a material effect on the consolidated financial statements.

The Corporation and its subsidiaries are subject to U.S. federal income tax. The Corporation is no longer subject to examination by taxing authorities for years before 2002. The Corporation does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Corporation did not have any amounts accrued for interest and penalties at January 1, 2007.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements.* This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. The Corporation has not completed its evaluation of the impact of the adoption of this standard.

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*, which provides all entities with an option to report selected financial assets and liabilities at fair value. The objective of FAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in earnings caused by measuring related assets and liabilities differently without having to apply the complex provisions of hedge accounting. FAS No. 159 is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007 provided the entity also elects to apply the provisions of FAS No. 157, *Fair Value Measurements*. The Corporation has not completed its evaluation of the impact of the adoption of this standard.

RECLASSIFICATIONS

Certain prior year amounts have been reclassified for comparative purposes.

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ITEM 2

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

The following discussion and analysis of the consolidated financial statements of CNB Financial Corporation (the Corporation) is presented to provide insight into management s assessment of financial results. The Corporation s subsidiary CNB Bank (the Bank) provides financial services to individuals and businesses within the Bank s market area which is primarily made up of the west central Pennsylvania counties of Cambria, Clearfield, Centre, Elk, Jefferson, McKean and Warren. During 2005 the Bank entered the northwestern Pennsylvania county of Erie and began doing business as ERIEBANK. The Bank is subject to regulation, supervision and examination by the Pennsylvania State Department of Banking as well as the Federal Deposit Insurance Corporation. The financial condition and results of operations are not intended to be indicative of future performance. One of the Corporation s subsidiaries, CNB Securities Corporation, is incorporated in Delaware and currently maintains investments in debt and equity securities. County Reinsurance Company, also a subsidiary, is a Corporation of Arizona, and provides credit life and disability for customers of CNB Bank. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Finally, Holiday Financial Services Corporation was formed in the fourth quarter of 2005 to facilitate the Corporation s entry into the consumer discount loan and finance business. Management s discussion and analysis should be read in conjunction with the consolidated financial statements and related notes.

Risk identification and management are essential elements for the successful management of the Corporation. In the normal course of business, the Corporation is subject to various types of risk, including interest rate, credit, and liquidity risk. These risks are controlled through policies and procedures established throughout the Corporation.

Interest rate risk is the sensitivity of net interest income and the market value of financial instruments to the direction and frequency of changes in interest rates. Interest rate risk results from various repricing frequencies and the maturity structure of the financial instruments owned by the Corporation. The Corporation uses its asset/liability management policy and systems to control, monitor and manage interest rate risk.

Credit risk represents the possibility that a customer may not perform in accordance to contractual terms. Credit risk results from loans with customers and the purchase of securities. The Corporation s primary credit risk is in the loan portfolio. The Corporation manages credit risk by following an established credit policy and through a disciplined evaluation of the adequacy of the allowance for loan losses. Also, the investment policy limits the amount of credit risk that may be taken in the securities portfolio.

Liquidity risk represents the inability to generate or otherwise obtain funds at reasonable rates to satisfy commitments to borrowers and obligations to depositors. The Corporation has established guidelines within its asset liability management policy to manage liquidity risk. These guidelines include contingent funding alternatives.

GENERAL OVERVIEW

During 2005, the Bank established a loan production office in Erie, Pennsylvania in order to begin offering commercial loan service to businesses located within Erie and Erie County. Management operated from temporary store locations in 2005 and 2006 and on September 13, 2007 opened its first new full service financial services store in Erie s west side. Two additional stores are currently under construction with expected completion dates in the first and second quarters of 2008. Management believes that our ERIEBANK division, along with our traditional CNB Bank market areas, should provide the Bank with sustained loan growth during the remainder of 2007.

In the fourth quarter of 2005, the Corporation formed a new subsidiary and entered the consumer discount loan and finance business as Holiday Financial Services Corporation. In 2006, we opened three new offices in the communities of Hollidaysburg, Northern Cambria and Clearfield, Pennsylvania. Three additional offices in the communities of Bellefonte, Ridgway and Bradford, Pennsylvania have been opened in 2007 bringing our total to seven. Although the consumer discount loan business is relatively new to the Corporation, management is making the necessary investments in experienced personnel and technology which we believe will facilitate the growth of Holiday Financial Services into a successful and profitable subsidiary of the Corporation in future years.

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While non-interest costs are expected to increase with the growth of the Corporation s banking and consumer discount loan franchises, these new ventures should provide growth in earning assets as well as enhanced non-interest income to more than offset these costs in 2008 and beyond. As such, the Corporation is making the necessary investments in 2007 knowing that earnings will be reduced in the near term due to costs increasing faster than related revenues.

The interest rate environment will continue to play an important rule in the future earnings of the Corporation. Our net interest margin remained strong in the nine months of 2007 even with the period of yield curve inversion which negatively affected the earnings of many financial institutions. Recent actions of the Federal Reserve have resulted in decreases in short term interest rates and the shift to a more normalized yield curve which is expected to benefit the Corporation in the future primarily by reducing its cost of funds. Management will closely monitor our net interest margin throughout the remainder of 2007, as well as continue to apply a disciplined approach to managing our balance sheet, as the majority of the earnings of the Corporation continue to be derived from interest income. Non-interest income should be enhanced in several areas including improved service charge and fee income as we enter new markets and grow transaction accounts.

Management concentrates on return on average equity and earnings per share evaluations, plus other methods to measure and direct the performance of the Corporation. While past results are not an indication of future earnings, we feel the Corporation is well positioned to enhance earnings through the remainder of 2007.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents totaled $28.5 million at September 30, 2007 compared to $25.5 million at December 31, 2006. Management believes the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable the Corporation to meet cash obligations and off-balance sheet commitments as they come due.

SECURITIES

Securities increased $5.5 million or 3.5% since December 31, 2006. The increase is primarily the result of purchases of structured collateralized mortgage obligations and U.S. Government Agency Securities.

The Corporation generally buys into the market over time and does not attempt to time its transactions. In doing this, the highs and lows of the market are averaged into the portfolio and minimize the overall effect of different rate environments. Management monitors the earnings performance and the effectiveness of the liquidity of the securities portfolio on a regular basis through Asset / Liability Committee (ALCO) meetings. The ALCO also reviews and manages interest rate risk for the Corporation. Through active balance sheet management and analysis of the securities portfolio, the Corporation maintains sufficient liquidity to satisfy depositor requirements and various credit needs of its customers.

LOANS

The Corporation s lending is primarily focused on the west central Pennsylvania market and consists principally of commercial lending primarily to locally owned small businesses and retail lending which includes single-family residential mortgages and other consumer lending. At September 30, 2007, the Corporation had $586.4 million in loans outstanding, net of unearned discount, an increase of $ 39.4 million (or 7.2%) since December 31, 2006. The increase was primarily the result of three factors. First was increasing demand for our commercial and residential mortgage products. The Corporation views commercial lending as its competitive advantage and continues to focus on this area by hiring and retaining experienced loan officers and supporting them with quality credit analysis. In addition, the Corporation ran two successful home equity loan promotions during the first nine months of 2007 which were the primary reason for the growth in residential mortgages of $15.7 million or 9.8%. Finally, the growth of our consumer discount loan and finance company, Holiday Financial Services Corporation, was the primary reason for the growth in installment loans of $8.3 million or 29.2% since December 31, 2006.

The Corporation expects increasing loan demand throughout the remainder of 2007 with the growth of our ERIEBANK division and Holiday Financial Services Corporation as well as improved demand in our traditional markets.

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Total loans, net of unearned discount, at September 30, 2007 and December 31, 2006 are summarized as follows:

($ in thousands)

	9/30/2007	12/31/2006
Commercial, Financial and Agricultural	$ 218,395	$ 214,804
Residential Mortgage	175,841	160,159
Commercial Mortgage	155,369	143,453
Installment	36,799	28,488
Lease Receivables		116
	$ 586,404	$ 547,020

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established by provisions for losses in the loan portfolio as well as overdrafts in deposit accounts. These provisions are charged against current income. Loans and overdrafts deemed not collectible are charged-off against the allowance while any subsequent collections are recorded as recoveries and increase the allowance.

The table below shows activity within the allowance account:

		Periods ending	
($ s in thousands)	**September 30, 2007**	**December 31, 2006**	**September 30, 2006**
Balance at beginning of Period	$ 6,086	$ 5,603	$ 5,603
Charge-offs:			
Commercial and financial	26		
Commercial mortgages	27	144	104
Residential mortgages	157	203	118
Installment	273	451	315
Lease receivables	2	21	20
Overdrafts	197	272	187
	682	1,091	744
Recoveries:			
Commercial and financial		3	6
Commercial mortgages		3	
Residential mortgages	12	4	4
Installment	72	89	71
Lease receivables		11	3
Overdrafts	61	93	69
	145	203	153
Net charge-off s:	(537)	(888)	(591)
Provision for loan losses	903	1,371	1,079
Balance at end-of-period	$ 6,452	$ 6,086	$ 6,091
Loans, net of unearned	$ 586,404	$ 547,020	$ 538,077
Allowance to net loans	1.10%	1.11%	1.13%

Net charge-offs to average loans	0.13%	0.17%	0.15%
Non performing assets	$ 2,608	$ 1,928	$ 2,244
Non performing % of total assets	0.31%	0.25%	0.29%

The adequacy of the allowance for loan and lease losses is subject to a formal analysis by the credit administrator of the Bank. As part of the formal analysis, delinquencies and losses are monitored monthly. The loan portfolio is divided into several categories in order to better analyze the entire pool. First is a selection of criticized loans that is given a specific reserve. The remaining loans are pooled, by category, into these segments:

Reviewed

Commercial and financial