EMCLAIRE FINANCIAL CORP
Form 10-Q
November 13, 2006

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

FORM 10-Q

(Mark One)

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

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: 000-18464

EMCLAIRE FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Pennsylvania	25-1606091
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

612 Main Street, Emlenton, Pennsylvania	16373
(Address of principal executive offices)	(Zip Code)

(724) 867-2311

(Registrant's telephone number)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer [] Accelerated filer [] Non-accelerated filer [X]

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

The number of shares outstanding of the Registrant's common stock was 1,267,835 at November 13, 2006.

EMCLAIRE FINANCIAL CORP.

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PART I - FINANCIAL INFORMATION

Item 1. Interim Financial Statements

Emclaire Financial Corp. and Subsidiary
Consolidated Balance Sheets
As of September 30, 2006 (Unaudited) and December 31, 2005
(Dollar amounts in thousands, except per share data)

	September 30, 2006	December 2005
Assets		
Cash and due from banks	$ 7,020	$
Interest-earning deposits with banks	472	
Cash and cash equivalents	7,492	
Securities available for sale, at fair value	52,582	
Securities held to maturity; fair value of $0 and $14	-	
Loans held for sale	2,400	
Loans receivable, net of allowance for loan losses of $1,985 and $1,869	214,961	1
Federal bank stocks, at cost	2,335	
Bank-owned life insurance	4,748	
Accrued interest receivable	1,472	
Premises and equipment, net	6,962	
Goodwill	1,422	
Deferred tax asset	451	
Prepaid expenses and other assets	660	
Total Assets	$ 295,485	$ 2
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 43,223	$
Interest-bearing	195,821	1
Total deposits	239,044	2

Short-term borrowed funds	500	
Long-term borrowed funds	30,000	
Accrued interest payable	747	
Accrued expenses and other liabilities	923	
Total Liabilities	271,214	2
Stockholders' Equity:		
Preferred stock, $1.00 par value, 3,000,000 shares authorized; none issued	-	
Common stock, $1.25 par value, 12,000,000 shares authorized; 1,395,852 shares issued; 1,267,835 shares outstanding	1,745	
Additional paid-in capital	10,871	
Treasury stock, at cost; 128,017 shares	(2,653)	
Retained earnings	14,532	
Accumulated other comprehensive loss	(224)	
Total Stockholders' Equity	24,271	
Total Liabilities and Stockholders' Equity	$ 295,485	$ 2

See accompanying notes to consolidated financial statements.

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Emclaire Financial Corp. and Subsidiary
Consolidated Statements of Income
For the three and nine months ended September 30, 2006 and 2005 (Unaudited)
(Dollar amounts in thousands, except per share data)

	For the three months ended September 30,		For the Se
	2006	2005	2006
Interest and dividend income:			
Loans receivable, including fees	$ 3,670	$ 3,104	$ 10,
Securities:			
Taxable	352	417	1,
Exempt from federal income tax	176	175	
Federal bank stocks	28	14	
Deposits with banks	14	23	
Total interest and dividend income	4,240	3,733	11,
Interest expense:			
Deposits	1,530	1,236	4,
Borrowed funds	324	169	

Total interest expense	1,854	1,405	4,
Net interest income	2,386	2,328	6,
Provision for loan losses	90	40	
Net interest income after provision for loan losses	2,296	2,288	6,
Noninterest income:			
Fees and service charges	387	403	1,
Commissions on financial services	101	88	
Gains on securities	134	290	
Gain on the sale of loans	9	2	
Earnings on bank-owned life insurance (BOLI)	53	44	
Other	109	93	
Total noninterest income	793	920	2,
Noninterest expense:			
Compensation and employee benefits	1,391	1,298	3,
Premises and equipment	387	401	1,
Intangible amortization expense	2	8	
Other	485	679	1,
Total noninterest expense	2,265	2,386	6,
Income before provision for income taxes	824	822	2,
Provision for income taxes	132	159	
Net income	$ 692	$ 663	$ 1,
Basic earnings per share	$ 0.55	$ 0.52	$ 1
Average common shares outstanding	1,267,835	1,267,835	1,267,

See accompanying notes to consolidated financial statements.

Emclaire Financial Corp. and Subsidiary
Condensed Consolidated Statements of Cash Flows
For the nine months ended September 30, 2006 and 2005 (Unaudited)
(Dollar amounts in thousands)

	For the nine months ended September 30,	
	2006	2005
Operating Activities:		

Net income	$ 1,880	$ 1,884
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization of premises and equipment	557	658
Provision for loan losses	168	145
Amortization of premiums and accretion of discounts, net	27	88
Gain on sale of loans	(9)	(5)
Gains on sale of securities available for sale	(376)	(510)
Earnings on bank-owned life insurance, net	(125)	(132)
Increase in accrued interest receivable	(201)	(112)
Decrease in prepaid expenses and other assets	119	144
Increase (decrease) in accrued interest payable	140	(9)
Decrease in accrued expenses and other liabilities	(369)	(128)
Net cash provided by operating activities	1,811	2,023
Investing Activities:		
Loan originations and principal collections, net	(26,049)	(10,110)
Proceeds from the sale of loans held for sale	1,016	541
Available-for-sale securities:		
Sales	814	1,232
Maturities, repayments and calls	4,714	5,663
Purchases	(1,753)	(4,458)
Held-to-maturity securities:		
Maturities, repayments and calls	15	1
Purchase of Federal bank stocks	(562)	(151)
Purchase of premises and equipment	(1,396)	(870)
Net cash used in investing activities	(23,201)	(8,152)
Financing Activities:		
Net increase (decrease) in deposits	8,542	(4,186)
Increase in borrowed funds	11,000	5,000
Dividends paid on common stock	(1,027)	(950)
Net cash provided by (used in) financing activities	18,515	(136)
Net decrease in cash and cash equivalents	(2,875)	(6,265)
Cash and cash equivalents at beginning of period	10,367	14,624
Cash and cash equivalents at end of period	$ 7,492	$ 8,359
Supplemental information:		
Interest paid	$ 4,811	$ 4,110
Income taxes paid	501	349
Supplemental noncash disclosures:		
Transfers from loans to foreclosed real estate	$ 20	$ 89
Transfer of loans receivable to loans held for sale	3,407	150

See accompanying notes to consolidated financial statements.

Emclaire Financial Corp. and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity
For the three and nine months ended September 30, 2006 and 2005 (Unaudited)
(Dollar amounts in thousands, except per share data)

	For the three months ended September 30, 2006	2005
Balance at beginning of period	$ 23,480	$ 23,882
Net income	692	663
Change in net unrealized gains (losses) on available for sale securities, net of taxes	529	(360)
Less reclassification adjustment for gains included in net income, net of taxes	(88)	(191)
Other comprehensive income (loss)	441	(551)
Total comprehensive income	1,133	112
Dividends declared	(342)	(317)
Balance at end of period	$ 24,271	$ 23,677
Common cash dividend per share	$ 0.27	$ 0.25

See accompanying notes to consolidated financial statements.

Emclaire Financial Corp. and Subsidiary
Notes to Consolidated Financial Statements

1. Nature of Operations and Basis of Presentation.

Emclaire Financial Corp. (the "Corporation") is a Pennsylvania company organized as the holding company of Farmers National Bank of Emlenton (the "Bank"). The Corporation provides a variety of financial services to individuals and businesses through its offices in western Pennsylvania. Its primary deposit products are checking, savings and certificate of deposit accounts and its primary lending products are residential and commercial mortgages, commercial business and consumer loans.

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiary, the Bank. All intercompany transactions and balances have been eliminated in preparing the consolidated financial statements.

The accompanying unaudited consolidated financial statements for the interim periods include all adjustments, consisting of normal recurring accruals, which are necessary, in the opinion of management, to fairly reflect the Corporation's consolidated financial position and results of operations. Additionally, these consolidated financial statements for the interim periods have been prepared in accordance with instructions for the Securities and Exchange Commission's Form 10-Q and therefore do not include all information or footnotes necessary for a complete presentation of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. For further information, refer to the audited consolidated financial statements and footnotes thereto for the year ended December 31, 2005, as contained in the Corporation's 2005 Annual Report to Stockholders.

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses. The results of operations for interim quarterly or year to date periods are not necessarily indicative of the results that may be expected for the entire year or any other period. Certain amounts previously reported may have been reclassified to conform to the current year's financial statement presentation.

2. Basic Earnings per Common Share.

The Corporation maintains a simple capital structure with no common stock equivalents. Basic earnings per common share is calculated using net income divided by the weighted average number of common shares outstanding during the period.

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3. Securities.

The Corporation's securities as of the respective dates are summarized as follows:

(Dollar amounts in thousands)	Amortized cost	Unrealized gains
Available for sale:		
September 30, 2006:		

U.S. Government agencies and related entities	$ 32,353	$ -	
Mortgage-backed securities	2,570	-	
Municipal securities	14,687	629	
Corporate securities	-	-	
Equity securities	3,310	36	
	$ 52,920	$ 665	
December 31, 2005:			
U.S. Government agencies and related entities	$ 34,353	$ -	
Mortgage-backed securities	3,046	-	
Municipal securities	14,685	664	
Corporate securities	2,249	4	
Equity securities	1,995	383	
	$ 56,328	$ 1,051	
Held to maturity:			
September 30, 2006:			
Mortgage-backed securities	$ -	$ -	
	$ -	$ -	
December 31, 2005:			
Mortgage-backed securities	$ 15	$ -	
	$ 15	$ -	

4. Loans Receivable.

The Corporation's loans receivable as of the respective dates are summarized as follows:

(Dollar amounts in thousands)	September 30, 2006
Mortgage loans on real estate:	
Residential first mortgages	$ 65,03
Home equity loans and lines of credit	47,39
Commercial real estate	61,73
	174,16
Other loans:	
Commercial business	34,96
Consumer	7,82
	42,78
Total loans, gross	216,94
Less allowance for loan losses	1,98

Total loans, net	$ 214,96

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5. Deposits.

The Corporation's deposits as of the respective dates are summarized as follows:

(Dollar amounts in thousands)

Type of accounts	Amount	%	Amou
Noninterest-bearing deposits	$43,223	18.1%	$
Interest-bearing demand deposits	72,732	30.4%	
Time deposits	123,089	51.5%	1
	$239,044	100.0%	$2

6. Guarantees.

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Of these letters of credit at September 30, 2006, $76,000 automatically renews within the next twelve months, $308,000 will expire within the next twelve months and $176,000 will expire within thirteen to thirty-seven months. The Corporation, generally, holds collateral and/or personal guarantees supporting these commitments. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The current amount of the liability as of September 30, 2006 for guarantees under standby letters of credit issued is not material.

7. Employee Benefit Plans.

Defined Contribution Plan.

The Corporation maintains a defined contribution 401(k) Plan. Employees are eligible to participate by providing tax-deferred contributions up to 20% of qualified compensation. Employee contributions are vested at all times. The Corporation makes matching contributions as approved by the Board of Directors. Matching contributions for the three months ended September 30, 2006 and 2005 amounted to $21,000 and $19,000, respectively. Matching contributions for the nine months ended September 30, 2006 and 2005 amounted to $63,000 and $56,000, respectively.

The Corporation provides pension benefits for eligible employees through a defined benefit pension plan. Substantially all employees participate in the retirement plan on a non-contributing basis and are fully vested after five years of service.

The Corporation uses a December 31 measurement date for its plans.

7. Employee Benefit Plans (continued).

The components of the periodic pension cost are as follows:

	For the three months ended September 30,		For the nin Septemb
(Dollar amounts in thousands)	2006	2005	2006
Service cost	$ 56	$ 57	$ 16
Interest cost	62	58	17
Expected return on plan assets	(69)	(62)	(20
Transition asset	(2)	(2)	(
Prior service costs	(7)	(8)	(2
Recognized net actuarial (gain) loss	23	18	4
Net periodic pension cost	$ 63	$ 61	$ 15

The expected rate of return on plan assets was 8.50% for the periods ended September 30, 2006 and 2005. The Corporation contributed $280,000 to its pension plan for the 2006 plan year during the quarter ended September 30, 2006.

8. Effect of Recently Issued Accounting Standards.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - An Amendment of FASB Statement No. 140" ("SFAS 156"). SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. SFAS 156 is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006, which for the Corporation will be as of the beginning of fiscal 2007. The Corporation does not believe that the adoption of SFAS 156 will have a significant effect on its consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." Specifically, the pronouncement prescribes a recognition threshold and a measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. The interpretation is effective for fiscal years beginning after December 15, 2006. The Corporation is evaluating the impact of this new pronouncement on its consolidated financial statements.

In September 2006, the FASB issued FASB Statement No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. FASB Statement No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. We are currently evaluating the potential impact, if any, of the adoption of FASB Statement No. 157 on our consolidated financial position, results of operations and cash flows.

8. Effect of Recently Issued Accounting Standards (continued).

On September 29, 2006, the Financial Accounting Standards Board "FASB" issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans ("SFAS 158"), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date -- the date at which the benefit obligation and plan assets are measured -- is required to be the company's fiscal year end. SFAS 158 is effective for publicly-held companies for fiscal years ending after December 15, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The Company is currently analyzing the effects of SFAS 158 but does not expect its implementation will have a significant impact on the Company's financial condition or results of operations.

On September 13, 2006, the Securities and Exchange Commission "SEC" issued Staff Accounting Bulleting No. 108 ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, Companies might evaluate the materiality of financial-statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company's balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. SAB 108 is effective for fiscal years ending after November 15, 2006. The Company is currently analyzing the effects of SAB 108 on the reported results of operations or financial condition.

In September 2006, the FASB issued FASB Staff Position AUG AIR-1, "Accounting for Planned Major Maintenance Activities" which is effective for fiscal years beginning after December 15, 2006. This position statement eliminates the accrue-in-advance method of accounting for planned major maintenance activities. We do not expect this pronouncement to have a significant impact on the determination or reporting of our financial results.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section discusses the consolidated financial condition and results of operations of Emclaire Financial Corp. (the "Corporation") and its wholly owned subsidiary bank, the Farmers National Bank of Emlenton (the "Bank"), for the three and nine month periods ended September 30, 2006 and should be read in conjunction with the Corporation's Annual Report of Form 10-K filed with the Securities and Exchange Commission and with the accompanying consolidated financial statements and notes presented on pages 1 through 8 of this Form 10-Q.

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words "believes," "anticipates," "contemplates" and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, the ability to control costs and expenses and general economic conditions. The Corporation does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

CHANGES IN FINANCIAL CONDITION

Total assets increased $20.0 million or 7.3% to $295.5 million at September 30, 2006 from $275.5 million at December 31, 2005. This increase was primarily due to increases in loans receivable, federal bank stocks and premises and equipment of $22.5 million, $562,000 and $839,000, respectively. Partially offsetting this increase were decreases in cash and cash equivalents and securities of $2.9 million and $3.7 million, respectively.

Loans receivable increased $22.5 million or 11.7% to $215.0 million at September 30, 2006 from $192.5 million at December 31, 2005. Loan production gained momentum during the first nine months of 2006 as commercial loans increased $16.0 million or 19.8% due to the continued focus by management on commercial lending. Also contributing to this increase was an increase in home equity loans of $7.5 million or 18.7% as a result of home equity advertising campaigns set forth in the first nine months of 2006.

During the quarter ended September 30, 2006, management identified $3.4 million in 30 year fixed rate conforming mortgage loans to sell to manage the Corporation's interest rate risk position. In September 2006, the Corporation sold $1.0 million of these mortgage loans.
Federal bank stocks increased $562,000 or 31.7% to $2.3 million at September 30, 2006 from $1.8 million at December 31, 2005 due to an increase in Federal Home Loan Bank capital stock requirements resulting from borrowing three additional $5.0 million term advances.

Premises and equipment increased $839,000 or 13.7% to $7.0 million at September 30, 2006 from $6.1 million at December 31, 2005. This increase was primarily due to constructing a new drive-thru facility in Brookville and a new branch facility proposed to open in November 2006.

Cash and cash equivalents decreased $2.9 million or 27.7% to $7.5 million at September 30, 2006 from $10.4 million at December 31, 2005. The decrease in cash and cash equivalents was primarily due to funding loan originations.

Securities decreased $3.7 million or 6.6% to $52.6 million at September 30, 2006 from $56.3 million at December 31, 2005 as a result of security maturities, sales and repayments of $5.5 million and an increase in unrealized losses on available for sale securities of $298,000, offset by security purchases of $1.8 million. The decrease in securities was primarily due to funding loan originations.

Long-term borrowed funds, consisting of Federal Home Loan Bank term advances, increased $15.0 million or 100.0% to $30.0 million at September 30, 2006 from $15.0 million at December 31, 2005. During June and July 2006, the Corporation entered into two separate agreements with the Federal Home Loan Bank to borrow two $5.0 million 10 year term advances at initial interest rates of 4.98% and 4.8275%, respectively. The interest rates are fixed for the first two years of the term after which the rates may adjust at the option of the Federal Home Loan Bank to the then three month LIBOR rate plus 24 basis points. During August 2006, the Corporation entered into an agreement with the Federal Home Loan Bank to borrow a $5.0 million 10 year term advance at an initial rate of 4.68%. The interest rate is fixed for the first two years of the initial term after which the rates may adjust at the option of the Federal Home Loan Bank to the then three month LIBOR rate plus 24 basis points, but only if the three month LIBOR exceeds 6.0%. If these advances convert to an adjustable rate borrowing, the Corporation has the opportunity to repay the advances without penalty at the conversion date.

Short-term borrowed funds, consisting of overnight Federal Home Loan Bank borrowings, decreased $4.0 million or 88.9% to $500,000 at September 30, 2006 from $4.5 million at December 31, 2005. The repayment of these overnight borrowings was funded by additional term advances, maturities of securities and growth in deposits.

Deposits increased $8.5 million or 3.7% to $239.0 million at September 30, 2006 from $230.5 million at December 31, 2005 as a result of an increase in time deposits due to marketing campaigns set forth in the first nine months of 2006.

Stockholders' equity increased $656,000 to $24.3 million at September 30, 2006 from $23.6 million at December 31, 2005. This increase was the result of net income of $1.9 million offset by dividends declared of $1.0 million and an increase in accumulated other comprehensive loss of $197,000, net of taxes. The increase in accumulated other comprehensive loss was the result of a decrease in the market value of available for sale securities.

RESULTS OF OPERATIONS

Comparison of Results for the Three Month Periods Ended September 30, 2006 and 2005

General. Net income increased $29,000 or 4.4% to $692,000 for the three months ended September 30, 2006 from $663,000 for the same period in 2005. This increase was a result of an increase in net interest income of $58,000 and decreases in noninterest expense and the provision for income taxes of $121,000 and $27,000, respectively, offset by an increase in the provision for loan losses of $50,000 and a decrease in noninterest income of $127,000.

Net interest income. Net interest income on a tax equivalent basis increased $65,000 or 2.7% to $2.5 million for the three months ended September 30, 2006 from $2.4 million for the same period in 2005. This net increase can be attributed to an increase in interest income of $515,000 offset by an increase in interest expense of $450,000.

Interest income. Interest income on a tax equivalent basis increased $515,000 or 13.4% to $4.4 million for the three months ended September 30, 2006, compared to $3.8 million for the same period in the prior year. This increase can be attributed to increases in interest earned on loans and federal bank stocks of $567,000 and $14,000, respectively, offset by decreases in interest earned on securities and interest-earning deposits with banks of $57,000 and $9,000, respectively.

The average balance of loans receivable increased $26.9 million or 14.2% to $216.4 million for the three months ended September 30, 2006, compared to $189.5 million for the same period in the prior year primarily due to increases in commercial mortgage loans, business loans and home equity loans as loan production increased throughout 2005 and the first nine months of 2006. The increase in volume contributed an additional $457,000 in interest income. Also contributing to this increase in volume was an increase in the yield on average loans receivable of 22 basis points to 6.79% during the three months ended September 30, 2006, compared to 6.57% for the same period in the prior year. The increased yield on the loan portfolio was driven by increased commercial loan production. Commercial loans are typically higher priced from an interest rate perspective. The increase in the average yield contributed an additional $110,000 in interest income.

The average balance of interest-earning cash equivalents decreased $1.2 million or 27.2% to $3.3 million for the three months ended September 30, 2006, compared to $4.6 million for the same period in the prior year. The decrease in the average balance was primarily due to funding requirements for loan originations. The decrease in the average balance resulted in a $12,000 reduction in interest income. Offsetting this decrease in volume was the increase in the yield on average interest-earning cash equivalents of 180 basis points to 5.02% during the three months ended September 30, 2006, compared to 3.22% for the same period in the prior year. The increase in yield, which was primarily due to increases in market rates, contributed an additional $17,000 to interest income.

The average balance of securities decreased $10.0 million or 16.1% to $51.8

million for the three months ended September 30, 2006, compared to $61.8 million for the same period in the prior year. The decrease in volume resulted in a $113,000 reduction in interest income. The decrease in the average balance of securities was primarily due to funding requirements for loan originations. Offsetting this decrease in volume was the increase in the yield on average securities of 38 basis points to 4.65% during the three months ended September 30, 2006, compared to 4.27% for the same period in the prior year. The increase in yield contributed an additional $56,000 to interest income.

Interest expense. Interest expense increased $450,000 or 32.0% to $1.9 million for the three months ended September 30, 2006, compared to $1.4 million for the same period in the prior year. This increase in interest expense can be attributed to increases in interest incurred on deposits and borrowed funds of $294,000 and $156,000, respectively.

Interest expense incurred on deposits increased $294,000 or 23.8% to $1.5 million for the three months ended September 30, 2006, compared to $1.2 million for the same period in the prior year. The average balance of interest-bearing deposits increased $4.4 million to $193.4 million for the three months ended September 30, 2006, compared to $189.0 million for the same period in the prior year. The average rate of interest-bearing deposits increased 55 basis points to 3.14% at September 30, 2006 from 2.59% for the same period in the prior year. The increases in volume and rate resulted in additional interest expense of $29,000 and $265,000, respectively.

Interest expense incurred on borrowed funds increased $156,000 or 92.3% to $325,000 for the three months ended September 30, 2006, compared to $169,000 for the same period in the prior year. This increase in interest expense can be attributed to the increase in the average balance of long-term and short-term borrowed funds of $10.6 million and $1.5 million, respectively, to $25.6 million and $2.5 million, respectively, for the three months ended September 30, 2006, compared to $15.0 million and $1.0 million, respectively, for the same period in the prior year which resulted in an additional $138,000 in interest expense. The increase in the average balance of long-term and short-term borrowed funds was primarily due to funding increased loan production. The average rate on the average balance of borrowed funds increased 40 basis points to 4.58% for the three months ended September 30, 2006 from 4.18% for the same period in the prior year and resulted in an additional $18,000 in interest expense. The increase in the average rate of borrowings was primarily due to increases in market rates.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resulting average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resulting average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average loan balances include non-accrual loans and exclude the allowance for loan losses and interest income includes accretion of net deferred loan costs. Interest and yields on tax-exempt loans and securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis. The information is based on average daily balances during the periods presented.

(Dollar amounts in thousands)	Three months ended Septembe			
	2006			
	Average Balance	Interest	Yield / Rate	A B
Interest-earning assets:				
Loans, taxable	$ 209,615	$ 3,593	6.80%	$
Loans, tax exempt	6,797	111	6.47%	
Total loans receivable	216,412	3,704	6.79%	
Securities, taxable	36,706	352	3.80%	
Securities, tax exempt	15,118	255	6.70%	
Total securities	51,824	607	4.65%	
Interest-earning deposits with banks	1,121	14	4.95%	
Federal bank stocks	2,201	28	5.05%	
Total interest-earning cash equivalents	3,322	42	5.02%	
Total interest-earning assets	271,558	4,353	6.36%	
Cash and due from banks	6,711			
Other noninterest-earning assets	13,740			
Total Assets	$ 292,009			$
Interest-bearing liabilities:				
Interest-bearing demand deposits	$ 73,362	224	1.21%	$
Time deposits	120,047	1,306	4.32%	
Total interest-bearing deposits	193,409	1,530	3.14%	
Borrowed funds, short-term	2,479	34	5.44%	
Borrowed funds, long-term	25,645	291	4.50%	
Total borrowed funds	28,124	325	4.58%	
Total interest-bearing liabilities	221,533	1,855	3.32%	
Noninterest-bearing demand deposits	44,674	-	-	
Funding and cost of funds	266,207	1,855	2.76%	
Other noninterest-bearing liabilities	2,105			

Total Liabilities	268,312		
Stockholders' Equity	23,697		
Total Liabilities and Stockholders' Equity	$ 292,009		$
Net interest income		$ 2,498	
Interest rate spread (difference between weighted average rate on interest-earning assets and interest-bearing liabilities)			3.04%
Net interest margin (net interest income as a percentage of average interest-earning assets)			3.65%

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Analysis of Changes in Net Interest Income. The following table analyzes the changes in interest income and interest expense in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Corporation's interest income and interest expense are attributable to changes in rate (change in rate multiplied by prior year volume), changes in volume (changes in volume multiplied by prior year rate) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances. Changes in interest income on loans and securities reflect the changes in interest income on a fully tax equivalent basis.

	Three months ended September 30, 2006 versus 2005 Increase (Decrease) due to	
(Dollar amounts in thousands)	Volume	Rate
Interest income:		
Loans	$ 457	$ 110
Securities	(113)	56
Interest-earning deposits with banks	(18)	9
Federal bank stocks	6	8
Total interest-earning assets	332	183
Interest expense:		
Deposits	29	265
Borrowed funds	138	18
Total interest-bearing liabilities	167	283

Net interest income	$ 165	$ (100)	

Provision for loan losses. The Corporation records provisions for loan losses to maintain a level of total allowance for loan losses that management believes, to the best of its knowledge, covers all known and inherent losses that are both probable and reasonably estimable at each reporting date. Management considers historical loss experience, the present and prospective financial condition of borrowers, current conditions (particularly as they relate to markets where the Corporation originates loans), the status of non-performing assets, the estimated underlying value of the collateral and other factors related to the collectibility of the loan portfolio.

Information pertaining to the allowance for loan losses and non-performing assets for the quarters ended September 30, 2006 and 2005 is as follows:

	At or for the three months ended September 30,	
(Dollar amounts in thousands)	2006	2005
Balance at the beginning of the period	$ 1,898	$ 1,
Provision for loan losses	90	
Charge-offs	(7)	
Recoveries	4	
Balance at the end of the period	$ 1,985	$ 1,
Non-performing loans	$ 1,653	$ 1,
Non-performing assets	1,739	1,
Non-performing loans to total loans	0.75%	0.
Non-performing assets to total assets	0.59%	0.
Allowance for loan losses to total loans	0.90%	0.
Allowance for loan losses to non-performing loans	120.08%	117.

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The provision for loan losses increased $50,000 or 125.0% to $90,000 for the three month period ended September 30, 2006 from $40,000 for the same period in the prior year. Management's evaluation of the loan portfolio, including the changing composition of the portfolio as well as economic trends, regulatory considerations and other factors contributed to the recognition of $90,000 in the provision for loan losses during the three months ended September 30, 2006.

Noninterest income. Noninterest income decreased $127,000 or 13.8% to $793,000 during the three months ended September 30, 2006, compared to $920,000 during the same period in the prior year. This decrease can be attributed to decreases in customer fees and service charges and gains on the sale of securities of $16,000 and $156,000, respectively. Offsetting this decrease in noninterest income were increases in commissions earned on financial services, gains on the sale of loans, earnings on bank-owned life insurance and other noninterest income of $13,000, $7,000, $9,000 and $16,000, respectively.

Noninterest expense. Noninterest expense decreased $121,000 or 5.1% to $2.3 million during the three months ended September 30, 2006, compared to $2.4 million during the same period in the prior year. This decrease in noninterest expense can be attributed to decreases in intangible amortization, premises and equipment and other noninterest expenses of $6,000, $14,000 and $194,000, respectively. Offsetting this decrease in noninterest expense was an increase in compensation and employee benefits of $93,000.

Other noninterest expense decreased $194,000 or 28.6% to $485,000 during the three months ended September 30, 2006, compared to $679,000 for the same period in the prior year. This decrease can be attributed primarily to decreases in telephone and communication, Pennsylvania use tax expense and other expenses. Partially offsetting these decreases were increases in MAC processing expense, printing and office supplies, postage, marketing and Pennsylvania shares tax expense between the two periods.

Provision for income taxes. The provision for income taxes decreased $27,000 or 17.0% to $132,000 for the three months ended September 30, 2006, compared to $159,000 for the same period in the prior year due primarily to the decrease in the effective tax rate to 16.0% in 2006 from 19.3% in 2005. The difference between the statutory rate of 34% and the Corporation's effective tax rate is due to tax-exempt income earned on loans, securities and bank-owned life insurance.

Comparison of Results for the Nine Month Periods Ended September 30, 2006 and 2005

General. Net income remained stable at $1.9 million for the nine month periods ended September 30, 2006 and 2005. This was a result of an increase in net interest income of $6,000 and a decrease in noninterest expenses of $71,000, offset by an increase in the provisions for loan losses and income taxes of $23,000 and $16,000, respectively, and a decrease in noninterest income of $42,000.

Net interest income. Net interest income on a tax equivalent basis increased $28,000 to $7.30 million for the nine months ended September 30, 2006 from $7.27 million for the same period in 2005. This net increase can be attributed to an increase in interest income of $878,000 offset by an increase in interest expense of $850,000.

Interest income. Interest income on a tax equivalent basis increased $878,000 or 7.7% to $12.3 million for the nine months ended September 30, 2006, compared to $11.4 million for the same period in the prior year. This increase can be attributed to increases in interest earned on loans and federal bank stocks of $1.1 million and $24,000, respectively, offset by decreases in interest earned on securities and interest-earning deposits with banks of $180,000 and $17,000, respectively.

The average balance of loans receivable increased $17.3 million or 9.3% to $203.8 million for the nine months ended September 30, 2006, compared to $186.5 million for the same period in the prior year primarily due to increases in commercial mortgage loans, business loans and home equity loans as loan production increased throughout 2005 and the first nine months of 2006. The yield on average loans receivable increased 13 basis points to 6.74% during the nine months ended September 30, 2006, compared to 6.61% for the same period in the prior year. The increase in the average yield was primarily due to the origination of loans with higher yields relative to portfolio loans as a result of the recent increase in interest rates. The increase in volume and yield contributed an additional $869,000 and $182,000, respectively, to interest income.

The average balance of interest-earning cash equivalents decreased $1.8 million or 34.5% to $3.4 million for the nine months ended September 30, 2006, compared to $5.2 million for the same period in the prior year. The decrease in the average balance was primarily due to funding requirements for loan originations and resulted in a $54,000 reduction in interest income. Offsetting this decrease in volume was an increase in the yield on average interest-earning cash equivalents of 183 basis points to 4.79% during the nine months ended September 30, 2006, compared to 2.96% for the same period in the prior year. The increase in yield, which was primarily due to increases in market rates, contributed an additional $37,000 to interest income.

The average balance of securities decreased $10.1 million or 15.9% to $53.6 million for the nine months ended September 30, 2006, compared to $63.7 million for the same period in the prior year. The decrease in volume resulted in a $343,000 reduction in interest income. The decrease in the average balance of securities was primarily due to funding requirements for loan originations. Offsetting this decrease in volume was an increase in the yield on average securities of 36 basis points to 4.64% during the nine months ended September 30, 2006, compared to 4.28% for the same period in the prior year. The increase in yield contributed an additional $163,000 to interest income.

Interest expense. Interest expense increased $850,000 or 20.7% to $5.0 million for the nine months ended September 30, 2006, compared to $4.1 million for the same period in the prior year. This increase in interest expense can be attributed to increases in interest incurred on deposits and borrowed funds of $673,000 and $177,000, respectively.

Interest expense incurred on deposits increased $673,000 or 18.6% to $4.3 million for the nine months ended September 30, 2006, compared to $3.6 million for the same period in the prior year. This increase in interest expense can be attributed to an increase in the average rate of interest-bearing deposits of 46 basis points to 3.00% for the nine months ended September 30, 2006 from 2.54% for the same period in the prior year. This increase in rate resulted from increases in market rates and resulted in an additional $664,000 of interest expense between the nine month period ended September 30, 2006 and 2005. Also contributing to the increase in interest expense was the increase in the average balance of interest-bearing deposits of $497,000 to $191.3 million at September 30, 2006, compared to $190.8 million for the same period in the prior year resulting in an additional $9,000 of interest expense.

Interest expense incurred on borrowed funds increased $177,000 or 36.8% to $658,000 for the nine months ended September 30, 2006, compared to $481,000 for the same period in the prior year. This increase in interest expense can be attributed to the increase in the average balance of borrowed funds of $4.8 million or 31.5% to $20.2 million for the nine months ended September 30, 2006, compared to $15.4 million for the same period in the prior year which resulted in an additional $157,000 in interest expense. The increase in the average balance of long-term and short-term borrowed funds was primarily due to funding increased loan originations. The average rate on the average balance of borrowed funds increased 17 basis points to 4.36% for the nine months ended September 30, 2006 from 4.19% for the same period in the prior year and resulted in an additional $20,000 in interest expense. The increase in the average rate of borrowing was primarily due to increases in market rates.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resulting average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resulting average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average loan balances include non-accrual loans and exclude the allowance for loan losses and interest income includes accretion of net deferred loan costs. Interest and yields on tax-exempt loans and securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis. The information is based on average daily balances during the periods presented.

	Nine months ended September 3			
	2006			
(Dollar amounts in thousands)	Average Balance	Interest	Yield / Rate	Ave Bal
Interest-earning assets:				
Loans, taxable	$ 196,972	$ 9,938	6.75%	$
Loans, tax exempt	6,835	330	6.46%	
Total loans receivable	203,807	10,268	6.74%	
Securities, taxable	38,332	1,103	3.85%	
Securities, tax exempt	15,235	758	6.65%	
Total securities	53,567	1,861	4.64%	
Interest-earning deposits with banks	1,585	55	4.64%	
Federal bank stocks	1,850	68	4.91%	
Total interest-earning cash equivalents	3,435	123	4.79%	
Total interest-earning assets	260,809	12,252	6.28%	
Cash and due from banks	6,908			
Other noninterest-earning assets	13,295			
Total assets	$ 281,012			$
Interest-bearing liabilities:				
Interest-bearing demand deposits	$ 73,103	545	1.00%	$
Time deposits	118,220	3,748	4.24%	
Total interest-bearing deposits	191,323	4,293	3.00%	

Borrowed funds, long-term	18,663	600	4.30%	
Borrowed funds, short-term	1,528	58	5.07%	
Total borrowed funds	20,191	658	4.36%	
Total interest-bearing liabilities	211,514	4,951	3.13%	
Noninterest-bearing demand deposits	43,604	-	-	
Funding and cost of funds	255,118	4,951	2.59%	
Other noninterest-bearing liabilities	2,271			
Total liabilities	257,389			
Stockholders' equity	23,623			
Total liabilities and stockholders' equity	$ 281,012			$
Net interest income		$ 7,301		
Interest rate spread (difference between weighted average rate on interest-earning assets and interest-bearing liabilities)			3.15%	
Net interest margin (net interest income as a percentage of average interest-earning assets)			3.74%	

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Analysis of Changes in Net Interest Income. The following table analyzes the changes in interest income and interest expense in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Corporation's interest income and interest expense are attributable to changes in rate (change in rate multiplied by prior year volume), changes in volume (changes in volume multiplied by prior year rate) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances. Changes in interest income on loans and securities reflect the changes in interest income on a fully tax equivalent basis.

	Nine months en 2006 ver Increase (De	
(Dollar amounts in thousands)	Volume	Ra

Interest income:	
Loans	$ 869
Securities	(343)
Interest-earning deposits with banks	(54)
Federal bank stocks	8
Total interest-earning assets	480
Interest expense:	
Deposits	9
Borrowed funds	157
Total interest-bearing liabilities	166
Net interest income	$ 314

Provision for loan losses. The Corporation records provisions for loan losses to maintain a level of total allowance for loan losses that management believes, to the best of its knowledge, covers all known and inherent losses that are both probable and reasonably estimable at each reporting date. Management considers historical loss experience, the present and prospective financial condition of borrowers, current conditions (particularly as they relate to markets where the Corporation originates loans), the status of non-performing assets, the estimated underlying value of the collateral and other factors related to the collectibility of the loan portfolio.

Information pertaining to the allowance for loan losses and non-performing assets for the nine months ended September 30, 2006 and 2005 is as follows:

	At or for the nine months ended September 30,	
(Dollar amounts in thousands)	2006	2005
Balance at the beginning of the period	$ 1,869	$ 1,810
Provision for loan losses	168	145
Charge-offs	(74)	(99)
Recoveries	22	37
Balance at the end of the period	$ 1,985	$ 1,893
Non-performing loans	$ 1,653	$ 1,608
Non-performing assets	1,739	1,705
Non-performing loans to total loans	0.75%	0.84%
Non-performing assets to total assets	0.59%	0.62%
Allowance for loan losses to total loans	0.90%	0.99%
Allowance for loan losses to non-performing loans	120.08%	117.72%

The provision for loan losses increased $23,000 or 15.9% to $168,000 for the nine month period ended September 30, 2006 from $145,000 for the same period in the prior year. Management's evaluation of the loan portfolio, including the changing composition of the portfolio as well as economic trends, regulatory considerations and other factors contributed to the recognition of $168,000 in the provision for loan losses during the nine months ended September 30, 2006.

Noninterest income. Noninterest income decreased $42,000 or 1.8% to $2.29 million during the nine months ended September 30, 2006, compared to $2.33 million during the same period in the prior year. This decrease can be attributed to decreases in commissions earned on financial services and gains on the sale of securities of $32,000 and $134,000, respectively. Offsetting this decrease in noninterest income were increases in customer fees and service charges, gains on the sale of loans and other noninterest income of $98,000, $4,000 and $22,000, respectively.

Noninterest expense. Noninterest expense decreased $71,000 or 1.0% to $6.7 million during the nine months ended September 30, 2006, compared to $6.8 million during the same period in the prior year. This decrease in noninterest expense can be attributed to decreases in intangible amortization and other noninterest expenses of $22,000 and $295,000, respectively. Offsetting this decrease in noninterest expense were increases in compensation and employee benefits and premises and equipment of $188,000 and $58,000, respectively.

Compensation and employee benefits expense increased $188,000 or 5.0% to $4.0 million during the nine months ended September 30, 2006, compared to $3.8 million for the same period in the prior year. Normal annual salary and wage adjustments, the increase in full-time equivalents, increased employee retirement costs, additional wages paid to temporary employees, higher director's fees and commissions paid to a financial services representative were the major components of this increase.

Premises and equipment expense increased $58,000 or 5.4% to $1.14 million during the nine months ended September 30, 2006, compared to $1.08 million for the same period in the prior year. The increase was primarily due to increased occupancy costs related to our new drive-thru facility in Brookville, as well as costs related to the construction of a new branch location.

Other noninterest expense decreased $295,000 or 15.6% to $1.6 million during the nine months ended September 30, 2006, compared to $1.9 million for the same period in the prior year. This decrease can be attributed primarily to decreases in professional fees, telephone and communication expenses, Pennsylvania use tax expense, travel and entertainment expenses and other noninterest expenses. Partially offsetting these decreases were increases in Pennsylvania shares tax expense, printing and office supplies, postage and marketing expenses between the two periods.

Provision for income taxes. The provision for income taxes increased $16,000 or 3.5% to $474,000 for the nine months ended September 30, 2006, compared to $458,000 for the same period in the prior year due to an increase in the Corporation's pre-tax earnings base between the first nine months of 2006 and 2005. Also contributing to the increase was the increase in the effective tax rate to 20.1% in 2006 from 19.6% in 2005 due to the expiration of tax credits generated in previous years. The difference between the statutory rate of 34% and the Corporation's effective tax rate is due to tax-exempt income earned on loans, securities and bank-owned life insurance.

LIQUIDITY

The Corporation's primary sources of funds generally have been deposits obtained through the offices of the Bank, borrowings from the FHLB and amortization and prepayments of outstanding loans and maturing securities. During the nine months ended September 30, 2006, the Corporation used its sources of funds primarily to fund loan originations and for the repayment of short-term borrowed funds. As of such date, the Corporation had outstanding loan commitments, including undisbursed loans and amounts available under credit lines, totaling $22.0 million, and standby letters of credit totaling $560,000.

At September 30, 2006, time deposits amounted to $123.1 million or 51.5% of the Corporation's total consolidated deposits, including approximately $44.9 million of which are scheduled to mature within the next year. Management of the Corporation believes that it has adequate resources to fund all of its commitments, that all of its commitments will be funded as required by related maturity dates and that, based upon past experience and current pricing policies, it can adjust the rates of time deposits to retain a substantial portion of maturing liabilities.

Aside from liquidity available from customer deposits or through sales and maturities of securities, the Corporation has alternative sources of funds such as a term borrowing capacity from the FHLB and, to a limited and rare extent, the sale of loans. At September 30, 2006, the Corporation's borrowing capacity with the FHLB, net of funds borrowed, was $106.7 million.

Management is not aware of any conditions, including any regulatory recommendations or requirements, which would adversely impact its liquidity or its ability to meet funding needs in the ordinary course of business.

CRITICAL ACCOUNTING POLICIES

Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions and where changes in those estimates and assumptions could have a significant impact on the financial statements. Management currently views the determination of the allowance for loan losses as a critical accounting policy.

The allowance for loan losses provides for an estimate of probable losses in the loan portfolio. In determining the appropriate level of the allowance for loan loss, the loan portfolio is separated into risk-rated and homogeneous pools. Migration analysis/historical loss rates, adjusted for relevant trends, have been applied to these pools. Qualitative adjustments are then applied to the portfolio to allow for quality of lending policies and procedures, national and local economic and business conditions, changes in the nature and volume of the portfolio, experience, ability and depth of lending management, changes in the trends, volumes and severity of past due, non-accrual and classified loans and loss and recovery trends, quality of the Corporation's loan review system, concentrations of credit, and external factors. The methodology used to determine the adequacy of the Corporation's allowance for loan losses is comprehensive and meets regulatory and accounting industry standards for assessing the allowance, however it is still an estimate. Loan losses are charged against the allowance while recoveries of amounts previously charged-off are credited to the allowance. Loan loss provisions are charged against current earnings based on management's periodic evaluation and review of the factors indicated above.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk for the Corporation consists primarily of interest rate risk exposure and liquidity risk. Since virtually all of the interest-earning assets and paying liabilities are at the Bank, virtually all of the interest rate risk and liquidity risk lies at the Bank level. The Bank is not subject to currency exchange risk or commodity price risk, and has no trading portfolio, and therefore, is not subject to any trading risk. In addition, the Bank does not participate in hedging transactions such as interest rate swaps and caps. Changes in interest rates will impact both income and expense recorded and also the market value of long-term interest-earning assets. Interest rate risk and liquidity risk management is performed at the Bank level. Although the Bank has a diversified loan portfolio, loans outstanding to individuals and businesses depend upon the local economic conditions in the immediate trade area.

One of the primary functions of the Corporation's asset/liability management committee is to monitor the level to which the balance sheet is subject to interest rate risk. The goal of the asset/liability committee is to manage the relationship between interest rate sensitive assets and liabilities, thereby minimizing the fluctuations in the net interest margin, which achieves consistent growth of net interest income during periods of changing interest rates.

Interest rate sensitivity is the result of differences in the amounts and repricing dates of the Bank's rate sensitive assets and rate sensitive liabilities. These differences, or interest rate repricing "gap", provide an indication of the extent that the Corporation's net interest income is affected by future changes in interest rates. A gap is considered positive when the amount of interest rate-sensitive assets exceeds the amount of interest rate-sensitive liabilities and is considered negative when the amount of interest rate-sensitive liabilities exceeds the amount of interest rate-sensitive assets. Generally, during a period of rising interest rates, a negative gap would adversely affect net interest income while a positive gap would result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would result in an increase in net interest income and a positive gap would adversely affect net interest income. The closer to zero that gap is maintained, generally, the lesser the impact of market interest rate changes on net interest income.

Based on certain assumptions provided by a federal regulatory agency, which management believes most accurately represents the sensitivity of the Corporation's assets and liabilities to interest rate changes, at September 30, 2006, the Corporation's interest-earning assets maturing or repricing within one year totaled $74.7 million while the Corporation's interest-bearing liabilities maturing or repricing within one-year totaled $80.8 million, providing an excess of interest-bearing liabilities over interest-earning assets of $6.1 million or a negative 2.1% of total assets. At September 30, 2006, the percentage of the Corporation's assets to liabilities maturing or repricing within one year was 92.5%.

For more information, see "Market Risk Management" in Exhibit 13 to the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005.

Item 4. Controls and Procedures

The Corporation maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Corporation's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls and procedures" in Rule 13a-15(e).

There has been no change made in the Corporation's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

As of the quarter ended September 30, 2006, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures. Based on the foregoing, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures were effective. There have been no significant changes in the Corporation's internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Corporation completed its evaluation.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation is involved in various legal proceedings occurring in the ordinary course of business. It is the opinion of management, after consultation with legal counsel, that these matters will not materially effect the Corporation's consolidated financial position or results of operations.

Item 1A. Risk Factors

There have been no material changes from risk factors as previously disclosed in the 2005 Form 10-K.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

(a) Not applicable.

(b) Not applicable.

Item 6. Exhibits

Exhibit 31.1 Rule 13a-14(a) Certification of Chief Executive Officer
Exhibit 31.2 Rule 13a-14(a) Certification of Chief Financial Officer
Exhibit 32.1 CEO Certification Pursuant to 18 U.S.C. Section 1350
Exhibit 32.2 CFO Certification Pursuant to 18 U.S.C. Section 1350

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Signatures

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

EMCLAIRE FINANCIAL CORP. AND SUBSIDIARY

Date: November 13, 2006 By: /s/ David L. Cox

David L. Cox
Chairman of the Board,
President and Chief Executive Officer

Date: November 13, 2006 By: /s/ William C. Marsh

William C. Marsh
Chief Financial Officer

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