ACNB CORP
Form 10-Q
May 07, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 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 March 31, 2010

Commission file number 0-11783

ACNB CORPORATION

(Exact name of Registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	**23-2233457** (I.R.S. Employer Identification No.)
16 Lincoln Square, Gettysburg, Pennsylvania (Address of principal executive offices)	**17325-3129** (Zip Code)

Registrant s telephone number, including area code: **(717) 334-3161**

Common Stock, Par Value $2.50 per Share

(Title of class)

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 o

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

The number of shares of the Registrant s Common Stock outstanding on April 30, 2010, was 5,928,343.

PART I - FINANCIAL INFORMATION

ACNB CORPORATION

ITEM 1 - FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

Dollars in thousands	March 31, 2010	March 31, 2009	December 31, 2009
ASSETS			
Cash and due from banks	**$ 13,470**	$ 12,890	$ 17,875
Interest bearing deposits with banks	**25,742**	14,868	6,263
Total Cash and Cash Equivalents	**39,212**	27,758	24,138
Securities available for sale	**198,359**	221,686	209,872
Securities held to maturity, fair value $10,391; $0; $10,334	**10,054**		10,057
Loans held for sale	**1,117**	4,861	145
Loans, net of allowance for loan losses $12,768; $8,635; $11,981	**645,448**	632,960	632,706
Premises and equipment	**14,754**	14,958	14,760
Restricted investment in bank stocks	**9,170**	9,170	9,170
Investment in bank-owned life insurance	**26,655**	25,541	26,408
Investments in low-income housing partnerships	**4,312**	4,647	4,391
Goodwill	**5,972**	5,972	5,972
Intangible assets	**4,184**	4,768	4,362
Foreclosed assets held for resale	**6,142**	483	6,046
Other assets	**13,607**	9,364	13,877
Total Assets	**$ 978,986**	$ 962,168	$ 961,904
LIABILITIES AND STOCKHOLDERS EQUITY			
LIABILITIES			
Deposits:			
Non-interest bearing	**$ 94,862**	$ 86,952	$ 93,829
Interest bearing	**639,378**	623,073	634,694
Total Deposits	**734,240**	710,025	728,523
Short-term borrowings	**44,251**	67,882	55,291
Long-term borrowings	**98,837**	86,874	80,294
Other liabilities	**11,274**	11,798	9,493
Total Liabilities	**888,602**	876,579	873,601
STOCKHOLDERS EQUITY			
Common stock, $2.50 par value; 20,000,000 shares authorized; 5,990,943 shares issued; 5,928,343, 5,935,943 and 5,928,343 shares outstanding	**14,977**	14,977	14,977

Treasury stock, at cost (62,600, 55,000 and 62,600 shares)		**(728)**		(640)		(728)
Additional paid-in capital		**8,787**		8,787		8,787
Retained earnings		**66,919**		63,900		65,623
Accumulated other comprehensive income (loss)		**429**		(1,435)		(356)
Total Stockholders Equity		**90,384**		85,589		88,303
Total Liabilities and Stockholders Equity	**$**	**978,986**	$	962,168	$	961,904

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Dollars in thousands, except per share data	Three Months Ended March 31, 2010	2009
INTEREST INCOME		
Loans, including fees	**$ 8,795**	$ 9,015
Securities:		
Taxable	**1,940**	2,355
Tax-exempt	**357**	380
Dividends	**7**	13
Other	**26**	12
Total Interest Income	**11,125**	11,775
INTEREST EXPENSE		
Deposits	**1,673**	2,653
Short-term borrowings	**42**	153
Long-term borrowings	**840**	1,071
Total Interest Expense	**2,555**	3,877
Net Interest Income	**8,570**	7,898
PROVISION FOR LOAN LOSSES	**859**	1,125
Net Interest Income after Provision for Loan Losses	**7,711**	6,773
OTHER INCOME		
Service charges on deposit accounts	**561**	540
Income from fiduciary activities	**277**	269
Earnings on investment in bank-owned life insurance	**247**	244
Net gains on sales of securities	**26**	9
Service charges on ATM and debit card transactions	**254**	227
Commissions from insurance sales	**1,197**	1,538
Other	**306**	300
Total Other Income	**2,868**	3,127
OTHER EXPENSES		
Salaries and employee benefits	**4,168**	4,373
Net occupancy	**608**	610
Equipment	**626**	560
Professional services	**245**	229
Other tax	**202**	157
Supplies and postage	**168**	189
Marketing	**71**	110
FDIC and regulatory	**357**	126
Intangible assets amortization	**161**	160
Other operating	**866**	739

Total Other Expenses		**7,472**		7,253
Income before Income Taxes		**3,107**		2,647
PROVISION FOR INCOME TAXES		**685**		531
Net Income	**$**	**2,422**	$	2,116
PER SHARE DATA				
Basic earnings	**$**	**0.41**	$	0.36
Cash dividends declared	**$**	**0.19**	$	0.19

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

Three Months Ended March 31, 2010 and 2009

Dollars in thousands	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
BALANCE JANUARY 1, 2009	$ 14,977	$ (442)	$ 8,787	$ 62,916	$ (1,799)	$ 84,439
Comprehensive income:						
Net income				2,116		2,116
Other comprehensive income, net of taxes					364	364
Total Comprehensive Income						2,480
Treasury stock purchased (20,000 shares)		(198)				(198)
Cash dividends declared				(1,132)		(1,132)
BALANCE MARCH 31, 2009	$ 14,977	$ (640)	$ 8,787	$ 63,900	$ (1,435)	$ 85,589
BALANCE JANUARY 1, 2010	**$ 14,977**	**$ (728)**	**$ 8,787**	**$ 65,623**	**$ (356)**	**$ 88,303**
Comprehensive income:						
Net income				**2,422**		**2,422**
Other comprehensive income, net of taxes					**785**	**785**
Total Comprehensive Income						**3,207**
Cash dividends declared				**(1,126)**		**(1,126)**
BALANCE MARCH 31, 2010	**$ 14,977**	**$ (728)**	**$ 8,787**	**$ 66,919**	**$ 429**	**$ 90,384**

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Dollars in thousands	Three Months Ended March 31, 2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 2,422**	$ 2,116
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of loans, property and foreclosed real estate		(131)
Earnings on investment in bank-owned life insurance	**(247)**	(244)
Gains on sales of securities	**(26)**	(9)
Depreciation and amortization	**608**	567
Provision for loan losses	**859**	1,125
Net accretion of investment securities discounts	**(3)**	(50)
(Increase)decrease in interest receivable	**(223)**	430
Increase in interest payable	**165**	288
Mortgage loans originated for sale	**(1,658)**	(15,982)
Proceeds from loans sold to others	**692**	12,212
Decrease in other assets	**175**	718
Increase (decrease) in other liabilities	**(317)**	91
Net Cash Provided by Operating Activities	**2,447**	1,131
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of investment securities available for sale	**12,468**	31,461
Proceeds from sales of investment securities available for sale	**3,216**	
Purchase of investment securities available for sale	**(1,006)**	
Net increase in loans	**(13,989)**	(3,755)
Cash paid for insurance agency acquisitions, net of cash acquired		4
Capital expenditures	**(448)**	(909)
Proceeds from sales of property and foreclosed real estate	**292**	151
Net Cash Provided by Investing Activities	**533**	26,952
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits	**1,033**	4,466
Net increase in time certificates of deposits and interest bearing deposits	**4,684**	15,262
Net decrease in short-term borrowings	**(11,040)**	(15,571)
Dividends paid	**(1,126)**	(1,132)
Purchase of treasury stock		(198)
Proceeds from long-term borrowings	**19,000**	
Repayments on long-term borrowings	**(457)**	(20,077)
Net Cash Provided by (Used in) Financing Activities	**12,094**	(17,250)
Net Increase in Cash and Cash Equivalents	**15,074**	10,833
CASH AND CASH EQUIVALENTS BEGINNING	**24,138**	16,925
CASH AND CASH EQUIVALENTS ENDING	**$ 39,212**	$ 27,758

Interest paid	**$**	**2,390**	$	3,589
Incomes taxes paid	**$**		$	
Loans transferred to foreclosed real estate	**$**	**388**	$	

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

ACNB CORPORATION

ITEM 1 - NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. **Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly ACNB Corporation s financial position as of March 31, 2010 and 2009, and the results of operations, changes in stockholders equity, and cash flows for the three months ended March 31, 2010 and 2009. All such adjustments are of a normal recurring nature.

The accounting policies followed by the Corporation are set forth in Note A to the Corporation s financial statements in the 2009 ACNB Corporation Annual Report on Form 10-K, filed with the SEC on March 12, 2010. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Corporation s Annual Report on Form 10-K. The results of operations for the three month period ended March 31, 2010, are not necessarily indicative of the results to be expected for the full year. For comparative purposes, the March 31, 2009, balances have been reclassified to conform with the 2010 presentation. Such reclassifications had no impact on net income.

The Corporation has evaluated events and transactions occurring subsequent to the balance sheet date of March 31, 2010, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

2. **Earnings Per Share**

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 5,936,001 and 5,952,221 weighted average shares of common stock outstanding for the three months ended March 31, 2010 and 2009, respectively. The Corporation does not have dilutive securities outstanding.

3. **Retirement Benefits**

The components of net periodic benefit costs related to the non-contributory pension plan for the three months ended March 31 were as follows:

	Three Months Ended March 31,	
In thousands	**2010**	**2009**

Service cost	**$**	**115**	$	140
Interest cost		**268**		247
Expected return on plan assets		**(304)**		(241)
Recognized net actuarial loss		**109**		145
Other, net		**13**		13
Net Periodic Benefit Cost	**$**	**201**	$	304

The Corporation previously disclosed in its financial statements for the year ended December 31, 2009, that it expected to contribute $1,250,000 to its pension plan in 2010. The full contribution was made to the plan during the first quarter of 2010. The Corporation reduced the benefit formula for the defined benefit pension plan effective January 1, 2010, in order to manage total benefit costs. The new formula is the earned benefit as of December 31, 2009, plus 0.75% of a participant s average monthly pay multiplied by years of benefit service earned on and after January 1, 2010, but not more than 25 years.

The benefit percentage factor and maximum years of service eligible were both reduced.

4. **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 written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. 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 Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $6,142,000 in standby letters of credit as of March 31, 2010. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees should be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability, as of March 31, 2010, for guarantees under standby letters of credit issued is not material.

5. **Comprehensive Income**

The Corporation s other comprehensive income items are unrealized gains on securities available for sale and unfunded pension liability. The components of other comprehensive income for the three months ended March 31 were as follows:

In thousands	**Three Months Ended March 31, 2010**	**2009**
Unrealized holding gains on available for sale securities arising during the period	**$ 1,094**	$ 561
Reclassification of gains realized in net income	**(26)**	(9)
Net Unrealized Gains	**1,068**	552
Tax effect	**363**	188
	705	364
Change in pension liability	**122**	
Tax effect	**42**	
	80	
Other Comprehensive Income	**$ 785**	$ 364

The components of the accumulated other comprehensive income (loss), net of taxes, are as follows:

In thousands	**Unrealized Gains on Securities**	**Pension Liability**	**Accumulated Other Comprehensive**

			Income (Loss)
BALANCE, MARCH 31, 2010	**$ 4,911**	**$ (4,482)**	**$ 429**
BALANCE, DECEMBER 31, 2009	$ 4,206	$ (4,562)	$ (356)
BALANCE, MARCH 31, 2009	$ 4,160	$ (5,595)	$ (1,435)

6. **Segment Reporting**

Russell Insurance Group, Inc. (RIG) is managed separately from the banking segment, which includes the bank and related financial services that the Corporation offers. RIG offers a broad range of property and casualty, life and health insurance to both commercial and individual clients.

Segment information for the three month periods ended March 31, 2010 and 2009, is as follows:

In thousands	**Banking**	**Insurance**	**Intercompany Eliminations**	**Total**
2010				
Net interest income and other income from external customers	**$ 10,254**	**$ 1,184**	$	**$ 11,438**
Income before income taxes	**2,963**	**144**		**3,107**
Total assets	**969,418**	**12,248**	**(2,680)**	**978,986**
Capital expenditures	**438**	**10**		**448**
2009				
Net interest income and other income from external customers	$ 9,496	$ 1,529	$	$ 11,025
Income before income taxes	2,258	389		2,647
Total assets	950,261	13,170	(1,263)	962,168
Capital expenditures	899	10		909

Intangible assets, representing customer lists, are amortized over 10 years on a straight line basis. Goodwill is not amortized, but rather is analyzed annually for impairment. However, amortization of goodwill and intangible assets is deductible for tax purposes.

7. Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported, net of tax, in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In assessing potential other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intent and ability to hold the securities until recovery of unrealized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

8

Amortized cost and fair value at March 31, 2010, and December 31, 2009, were as follows:

In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
MARCH 31, 2010				
U.S. Government and agencies	**$ 22,093**	**$ 316**	**$**	**$ 22,409**
Mortgage-backed securities	**119,743**	**6,255**	**1**	**125,997**
State and municipal	**37,527**	**589**	**86**	**38,030**
Corporate bonds	**9,922**	**285**		**10,207**
Mutual funds	**1,007**			**1,007**
Stock in other banks	**626**	**83**		**709**
	$ 190,918	**$ 7,528**	**$ 87**	**$ 198,359**
DECEMBER 31, 2009				
U.S. Government and agencies	$ 24,117	$ 316	$ 105	$ 24,328
Mortgage-backed securities	128,073	5,489	65	133,497
State and municipal	40,723	631	83	41,271
Corporate bonds	9,959	215		10,174
Stock in other banks	627		25	602
	$ 203,499	$ 6,651	$ 278	$ 209,872
SECURITIES HELD TO MATURITY				
MARCH 31, 2010				
U.S. Government and agencies	**$ 10,054**	**$ 337**	**$**	**$ 10,391**
SECURITIES HELD TO MATURITY				
DECEMBER 31, 2009				
U.S. Government and agencies	$ 10,057	$ 277	$	$ 10,334

At March 31, 2010, one mortgage-backed security had an unrealized loss that did not exceed 1% of amortized cost. This security has not been in a continuous loss position for 12 months or more. This unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the specific security. At March 31, 2010, fifteen state and municipal bonds had an unrealized loss, none of which has been in a continuous loss position for 12 months or more. In analyzing the issuer s financial condition, management considers industry analysts reports, financial performance, and projected target prices of investment analysts within a one-year time frame. The securities in this category had an unrealized loss that did not exceed 5% of amortized cost. Based on the above information, management has determined that none of these investments are other-than-temporarily impaired.

The fair values of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or by matrix pricing (Level 2) which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses an independent service provider to provide matrix pricing and uses the valuation of another provider to compare for reasonableness.

Management routinely sells securities from its available for sale portfolio in an effort to manage and allocate the portfolio. At March 31, 2010, management had not identified any securities with an unrealized loss that it intends to sell.

The following table shows the Corporation s gross unrealized losses and fair value related to investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2010, and December 31, 2009:

	Less than 12 Months		12 Months or More		Total	
In thousands	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
SECURITIES AVAILABLE FOR SALE						
MARCH 31, 2010						
Mortgage-backed securities	**$ 690**	**$ 1**	$	$	**$ 690**	**$ 1**
State and municipal	**6,012**	**86**			**6,012**	**86**
	$ 6,702	**$ 87**	**$**	**$**	**$ 6,702**	**$ 87**
DECEMBER 31, 2009						
U.S. Government and agencies	$ 7,953	$ 105	$	$	$ 7,953	$ 105
Mortgage-backed securities	16,426	62	482	3	16,908	65
State and municipal	7,757	83			7,757	83
Stock in other banks	602	25			602	25
	$ 32,738	$ 275	$ 482	$ 3	$ 33,220	$ 278

Amortized cost and fair value at March 31, 2010, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	Available for Sale		Held to Maturity	
In thousands	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
1 year or less	**$ 1,491**	**$ 1,498**	**$**	**$**
Over 1 year through 5 years	**20,302**	**20,705**	**10,054**	**10,391**
Over 5 years through 10 years	**28,660**	**29,290**		
Over 10 years	**19,089**	**19,153**		
Mortgage-backed securities	**119,743**	**125,997**		
Mutual funds and stock in other banks	**1,633**	**1,716**		
	$ 190,918	**$ 198,359**	**$ 10,054**	**$ 10,391**

The Corporation realized gross gains of $74,000 during the first quarter of 2010 and $9,000 during the first quarter of 2009 and gross losses of $48,000 during the first quarter of 2010 and $0 during the first quarter of 2009 on sales of securities available for sale. State and municipal securities were sold at a loss in order to adjust the Corporation s interest rate sensitivity, reduce exposure to geographical locations, and balance the mix with other investment types, and to reduce risks related to insurance coverage.

10

At March 31, 2010, and December 31, 2009, securities with a carrying value of $97,183,000 and $96,927,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements, and for other purposes.

8. **Fair Value of Financial Instruments**

Management uses its best judgment in estimating the fair value of the Corporation s financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period end.

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Additional guidance is provided on determining when the volume and level of activity for the asset or liability has significantly decreased. The standard also includes guidance on identifying circumstances when a transaction may not be considered orderly.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with fair value measurement and disclosure guidance.

This guidance further clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Fair value measurement and disclosure guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset or liability s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis on measurement used at March 31, 2010, and December 31, 2009, are as follows:

		Fair Value Measurements at March 31, 2010			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
Securities available for sale	**Recurring**	**$ 198,359**	**$ 709**	**$ 197,650**	**$**
Impaired loans	**Nonrecurring**	**4,259**			**4,259**
Foreclosed real estate	**Nonrecurring**	**6,142**			**6,142**
Loans held for sale	**Nonrecurring**	**1,117**			**1,117**

		Fair Value Measurements at December 31, 2009			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
Securities available for sale	Recurring	$ 209,872	$ 602	$ 209,270	$
Impaired loans	Nonrecurring	4,447			4,447
Foreclosed real estate	Nonrecurring	6,046			6,046
Loans held for sale	Nonrecurring	145			145

The following table presents a reconciliation of impaired loans, foreclosed real estate, and loans held for sale measured at fair value, using significant unobservable inputs (Level 3), for the quarter ended March 31, 2010:

In thousands	**Impaired Loans**	**Foreclosed Real Estate**	**Loans Held for Sale**
Balance January 1, 2010	**$ 4,447**	**$ 6,046**	**$ 145**
Gains on sales of loans			**6**
Settled or otherwise removed from impaired status	**(30)**	**(292)**	
Additions to impaired status		**388**	
Payments made	**(279)**		
Increase in valuation allowance	**121**		
Loan originations			**1,658**
Loan sales			**(692)**
Balance March 31, 2010	**$ 4,259**	**$ 6,142**	**$ 1,117**

Accounting Standards Codification (ASC) Topic 825, *Financial Instruments,* requires disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies, as well as in annual financial statements.

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Corporation s financial instruments at March 31, 2010, and December 31, 2009:

Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets   fair value.

Securities

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or by matrix pricing (Level 2) which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses an independent service provider to provide matrix pricing and uses the valuation of another provider to compare for reasonableness.

Mortgage Loans Held for Sale (Carried at Lower of Cost or Fair Value)

The fair values of mortgage loans held for sale are determined as the par amounts to be received at settlement by establishing the respective buyer and rate in advance.

Loans (Carried at Cost)

The fair values of loans are estimated using discounted cash flow analyses, as well as using market rates at the balance sheet date that reflect the credit and interest rate risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments, and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value)

Loans for which the Corporation has measured impairment are generally based on the fair value of the loan s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less the valuation allowance.

Foreclosed Real Estate

Fair value of real estate acquired through foreclosure is based on independent third-party appraisals of the properties. These assets are included as Level 3 fair values, based on appraisals that consider the sales prices of similar properties in the proximate vicinity.

Restricted Investment in Bank Stock (Carried at Cost)

The carrying amount of required and restricted investment in correspondent bank stock approximates fair value, and considers the limited marketability of such securities.

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Deposits (Carried at Cost)

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (e.g., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-Term Borrowings (Carried at Cost)

The carrying amounts of short-term borrowings approximate their fair values.

Long-Term Borrowings (Carried at Cost)

Fair values of Federal Home Loan Bank (FHLB) advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Off-Balance Sheet Credit-Related Instruments

Fair values for the Corporation s off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing.

Estimated fair values of financial instruments at March 31, 2010, and December 31, 2009, were as follows:

	March 31, 2010		**December 31, 2009**	
In thousands	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:				
Cash and due from banks	**$ 13,470**	**$ 13,470**	$ 17,875	$ 17,875
Interest bearing deposits in banks	**25,742**	**25,742**	6,263	6,263
Investment securities:				
Available for sale	**198,359**	**198,359**	209,872	209,872
Held to maturity	**10,054**	**10,391**	10,057	10,334
Loans held for sale	**1,117**	**1,117**	145	145
Loans, less allowance for loan losses	**645,448**	**663,620**	632,706	648,508
Accrued interest receivable	**3,881**	**3,881**	3,658	3,658
Restricted investment in bank stocks	**9,170**	**9,170**	9,170	9,170
Financial liabilities:				
Deposits	**734,240**	**737,783**	728,523	732,089
Short-term borrowings	**44,251**	**44,251**	55,291	55,291
Long-term borrowings	**98,837**	**102,052**	80,294	83,305
Accrued interest payable	**2,287**	**2,287**	2,122	2,122
Off-balance sheet financial instruments				

9. **New Accounting Pronouncements**

ASU 2009-05

In August 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-05, *Fair Value Measurements and Disclosures (Topic 820): Measuring Liabilities at Fair Value.* The amendments within ASU 2009-05 clarify that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques:

- A valuation technique that uses:

a. The quoted price of the identical liability when traded as an asset.

b. Quoted prices for similar liabilities or similar liabilities when traded as assets.

- Another valuation technique that is consistent with the principles of Topic 820.

Two examples would be an income approach, such as a present value technique, or a market approach, such as a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer the identical liability or would receive to enter into the identical liability.

When estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability.

Both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements.

This guidance became effective January 1, 2010, and did not have a significant impact on the Corporation s financial condition or results of operations.

ASU 2009-16

In October 2009, the FASB issued ASU 2009-16, *Transfers and Servicing* (*Topic 860*): *Accounting for Transfers of Financial Assets*. This Update amends the Codification for the issuance of FASB Statement No. 166, *Accounting for Transfers of Financial Assets - An amendment of FASB Statement No. 140.*

The amendments in this Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting.

This guidance became effective January 1, 2010, and did not have a significant impact on the Corporation s financial condition or results of operations.

ASU 2010-06

The FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB s objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require:

- A reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and,

- In the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances and settlements.

In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures:

- For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and,

• A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

ASU 2010-06 is effective for interim and annual reporting periods beginning January 1, 2010, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Corporation adopted the required provisions of ASU 2010-06, with no significant impact on its financial condition or results of operations.

ASU 2010-09

The FASB issued ASU 2010-09, *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements*. The amendments in the ASU remove the requirement for an SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of U.S. GAAP. The FASB also clarified that if the financial statements have been revised, then an entity that is not an SEC filer should disclose both the date that the financial statements were issued or available to be issued and the date the revised financial statements were issued or available to be issued. The FASB believes these amendments remove potential conflicts with the SEC s literature.

In addition, the amendments in the ASU require an entity that is a conduit bond obligor for conduit debt securities that are traded in a public market to evaluate subsequent events through the date of issuance of its financial statements and must disclose such date.

All of the amendments in the ASU were effective upon issuance (February 24, 2010) except for the use of the issued date for conduit debt obligors. That amendment is effective for interim or annual periods ending after June 15, 2010. The Corporation adopted the required provisions of ASU 2010-09, with no significant impact on its financial condition or results of operations.

ASU 2010-15

The FASB issued ASU 2010-15, *Financial Services - Insurance (Topic 944): How Investments Held through Separate Accounts Affect an Insurer s Consolidation Analysis of Those Investments*. This Update clarifies that an insurance entity should not consider any separate account interests held for the benefit of policyholders in an investment to be the insurer s interests and should not combine those interests with its general account interest in the same investment when assessing the investment for consolidation, unless the separate account interests are held for the benefit of a related party policyholder as defined in the Variable Interest Entities Subsections of Subtopic 810-10 and those Subsections require the consideration of related parties.

This Update also amends Subtopic 944-80 to clarify that for the purpose of evaluating whether the retention of specialized accounting for investments in consolidation is appropriate, a separate account arrangement should be considered a subsidiary. The amendments do not require an insurer to consolidate an investment in which a separate account holds a controlling financial interest if the investment is not or would not be consolidated in the standalone financial statements of the separate account.

The amendments also provide guidance on how an insurer should consolidate an investment fund in situations in which the insurer concludes that consolidation is required.

The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. Early adoption is permitted. The amendments in this Update should be applied retrospectively to all prior periods upon the date of adoption. The Corporation does not expect the adoption of this standard will have a significant impact on the Corporation s financial condition or results of operations.

ACNB CORPORATION

ITEM 2 - MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION AND FORWARD-LOOKING STATEMENTS

Introduction

The following is management s discussion and analysis of the significant changes in the financial condition, results of operations, capital resources, and liquidity presented in its accompanying consolidated financial statements for ACNB Corporation (the Corporation or ACNB), a financial holding company. Please read this discussion in conjunction with the consolidated financial statements and disclosures included herein. Current performance does not guarantee, assure or indicate similar performance in the future.

Forward-Looking Statements

In addition to historical information, this Form 10-Q contains forward-looking statements. Examples of forward-looking statements include, but are not limited to, (a) projections or statements regarding future earnings, expenses, net interest income, other income, earnings or loss per share, asset mix and quality, growth prospects, capital structure, and other financial terms, (b) statements of plans and objectives of management or the Board of Directors, and (c) statements of assumptions, such as economic conditions in the Corporation s market areas. Such forward-looking statements can be identified by the use of forward-looking terminology such as believes , expects , may , intends , will , should , anticipates negative of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy. Forward-looking statements are subject to certain risks and uncertainties such as local economic conditions, competitive factors, and regulatory limitations. Actual results may differ materially from those projected in the forward-looking statements. Such risks, uncertainties and other factors that could cause actual results and experience to differ from those projected include, but are not limited to, the following: ineffectiveness of the business strategy due to changes in current or future market conditions; the effects of economic deterioration on current customers, specifically the effect of the economy on loan customers ability to repay loans; the effects of competition, and of changes in laws and regulations on competition, including industry consolidation and development of competing financial products and services; interest rate movements; the inability to achieve merger-related synergies; difficulties in integrating distinct business operations, including information technology difficulties; disruption from the transaction making it more difficult to maintain relationships with customers and employees, and challenges in establishing and maintaining operations in new markets; volatilities in the securities markets; and, deteriorating economic conditions. We caution readers not to place undue reliance on these forward-looking statements. They only reflect management s analysis as of this date. The Corporation does not revise or update these forward-looking statements to reflect events or changed circumstances. Please carefully review the risk factors described in other documents the Corporation files from time to time with the Securities and Exchange Commission, including the Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and any Current Reports on Form 8-K.

CRITICAL ACCOUNTING POLICIES

The accounting policies that the Corporation s management deems to be most important to the portrayal of its financial condition and results of operations, and that require management s most difficult, subjective or complex judgment, often result in the need to make estimates about the effect of such matters which are inherently uncertain. The following policies are deemed to be critical accounting policies by management:

The allowance for loan losses represents management s estimate of probable losses inherent in the loan portfolio. Management makes numerous assumptions, estimates and adjustments in determining an adequate allowance. The Corporation assesses the level of potential loss associated with its loan portfolio and provides for that exposure through an allowance for loan losses. The allowance is established through a provision for loan losses charged to earnings. The allowance is an estimate of the losses inherent in the loan portfolio as of the end of each reporting period. The Corporation assesses the adequacy of its allowance on a quarterly basis. The specific methodologies applied on a consistent basis are discussed in greater detail under the caption, *Allowance for Loan Losses*, in a subsequent section of this Management s Discussion and Analysis of Financial Condition and Results of Operations.

The evaluation of securities for other-than-temporary impairment requires a significant amount of judgment. In estimating other-than-temporary impairment losses, management considers various factors including the length of time the fair value has been below cost, the financial condition of the issuer, and the Corporation s intent to sell, or requirement to sell, the security before recovery of its value. Declines in fair value that are determined to be other than temporary are charged against earnings.

ASC Topic 350, *Intangibles Goodwill and Other,* requires that goodwill is not amortized to expense, but rather that it be tested for impairment at least annually. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. The Corporation did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of December 31, 2009. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur. Other acquired intangible assets with finite lives, such as customer lists, are required to be amortized over the estimated lives. These intangibles are generally amortized using the straight line method over estimated useful lives of ten years.

RESULTS OF OPERATIONS

Quarter ended March 31, 2010, compared to quarter ended March 31, 2009

Executive Summary

Net income for the three months ended March 31, 2010, was $2,422,000 compared to $2,116,000 for the same quarter in 2009, an increase of $306,000 or 14%. Earnings per share increased from $0.36 in 2009 to $0.41 in 2010. Net interest income increased $672,000 or 9%; provision for loan losses decreased $266,000 or 24%; other income decreased $259,000 or 8%; and, other expenses increased $219,000 or 3%.

Net Interest Income

Net interest income totaled $8,570,000 for the quarter ended March 31, 2010, compared to $7,898,000 for the same period in 2009, an increase of $672,000 or 9%. Net interest income increased due to a decrease in interest expense resulting from reductions in market rates associated with the continued low rates maintained by the Federal Reserve Bank. Alternative funding sources, such as the FHLB, and other market driver rates are factors in rates the Corporation and the local market pay for deposits. At the end of the first quarter of 2010, several of the core deposit rates continued at practical floors after the Federal Open Market Committee decreased the Federal Funds Target Rate by 400 basis points during 2008 and maintained it at 0% to 0.25% since that time. Interest expense decreased $1,322,000 or 34%. The lower funding costs were partially offset by lower interest income, which decreased $650,000 or 6%. Interest income was lower as a result of investment securities paydowns that were not reinvested due to artificially low market rates resulting from Federal Reserve buying activities. Interest income also decreased due to declines in the Federal Funds Target Rate and other market driver rates. These driver rates are indexed to a portion of the loan portfolio in a manner that a decrease in the driver rates decreases the yield on the loans at subsequent rate reset dates. For more information about interest rate risk, please refer to Item 7A - Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K dated December 31, 2009, and filed with the SEC on March 12, 2010. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the first quarter of 2010 was 3.81% compared to 3.40% during the same period in 2009. Also comparing the first quarter of 2010 to 2009, the yield on interest earning assets decreased by 0.24% and the cost of interest bearing liabilities decreased by 0.65%. The net interest margin was 3.97% for the first quarter of 2010 and 3.64% for the first quarter of 2009. The net interest margin improvement was mainly a result of the cost of funding decreasing at a higher rate than the rate of change in the yield on assets due to timing of repricing, local market competition, and a steep yield curve that currently favors financial institutions.

Average earning assets were $880,008,000 during the first quarter of 2010, a decrease of $7,084,000 from the average for the first quarter of 2009. Average interest bearing liabilities were $769,278,000 in the first quarter of 2010, a decrease of $17,320,000 from the same quarter in 2009.