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EMCLAIRE FINANCIAL CORP
Form 10KSB
March 30, 2004

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

FORM 10-KSB

(Mark One):

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2003

TRANSITION REPORT UNDER 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.

(Name of small business issuer in its charter)

Pennsylvania

25-1606091

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

612 Main Street, Emlenton, PA

16373

(Address of principal executive office)

(Zip Code)

Issuer's telephone number: (724) 867-2311

Securities registered under Section 12(b) of the Exchange Act: None.

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value \$1.25 per share

(Title of Class)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 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 NO .

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for its most recent fiscal year. \$15,994,000

As of February 29, 2004, there were issued and outstanding 1,267,835 shares of the Registrant's Common Stock.

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The Registrant's Common Stock trades on the OTC Electronic Bulletin Board under the symbol "EMCF." The aggregate market value of the Common Stock held by non-affiliates of the registrant, based on the last price the registrant's Common Stock was sold on March 10, 2004, was \$28,111,439 (\$26.50 per share average bid and ask prices of \$25.75 and \$26.50, respectively, based on 1,267,835 shares of Common Stock outstanding).

DOCUMENTS INCORPORATED BY REFERENCE

- 1. Portions of the Annual Report to Stockholders for the Fiscal Year ended December 31, 2003 (Parts I, II, and IV).
2. Portions of the Proxy Statement for the May 19, 2004 Annual Meeting of Stockholders (Part III).

Transition Small Business Disclosure Format (Check one) YES [] NO [X]

EMCLAIRE FINANCIAL CORP.

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PART I

Item 1. Description of Business

Forward Looking Statements

Discussions of certain matters in this Form 10-KSB and other related year end documents may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and as such, may involve risks and uncertainties. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations, are generally identifiable by the use of words or phrases such as "believe", "plan", "expect", "intend", "anticipate", "estimate", "project", "forecast", "may increase", "may fluctuate", "may improve" and similar expressions of future or conditional verbs such as "will", "should", "would", and "could". These forward-looking statements relate to, among other things, expectations of the business environment in which the Corporation operates, projections of future performance, potential future credit experience, perceived opportunities in the market and statements regarding the Corporation's mission and vision. The Corporation's actual results, performance and achievements may differ materially from the results, performance, and achievements expressed or implied in such forward-looking statements due to a wide range of factors. These factors include, but are not limited to, changes in interest rates, general economic conditions, the local economy, the demand for the Corporation's products and services, accounting principles or guidelines, legislative and regulatory changes, monetary and fiscal policies of the U.S. Government, U.S. Treasury, and Federal Reserve, real estate markets, competition in the financial services industry, attracting and retaining key personnel, performance of new employees, regulatory actions, changes in and utilization of new technologies and other risks detailed in the Corporation's reports filed with the Securities and Exchange Commission (SEC) from time to time. These factors and those discussed under "Risk Factors" should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. 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.

General

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Emclair Financial Corp. (the Corporation) is a Pennsylvania corporation and bank holding company that provides a full range of retail and commercial financial products and services to customers in western Pennsylvania through its wholly owned subsidiary bank, the Farmers National Bank of Emlenton (the Bank).

The Bank was organized in 1900 as a national banking association and is a financial intermediary whose principal business consists of attracting deposits from the general public and investing such funds in real estate loans secured by liens on residential and commercial property, consumer loans, commercial business loans, marketable securities and interest-earning deposits. The Bank operates through a network of ten retail branch offices in Venango, Butler, Clarion, Clearfield, Elk and Jefferson counties, Pennsylvania. The Corporation and the Bank are headquartered in Emlenton, Pennsylvania.

The Corporation and the Bank are subject to examination and comprehensive regulation by the Office of the Comptroller of the Currency (OCC), which is the Bank's chartering authority, and the Federal Deposit Insurance Corporation (FDIC), which insures customer deposits held by the Bank to the full extent provided by law. The Bank is a member of the Federal Reserve Bank of Cleveland (FRB) and the Federal Home Loan Bank of Pittsburgh (FHLB). The Corporation is a registered bank holding company pursuant to the Bank Holding Company Act of 1956 (BHCA), as amended.

At December 31, 2003, the Corporation had \$262.5 million in total assets, \$22.7 million in stockholders' equity, \$190.5 million in loans and \$217.1 million in deposits.

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Lending Activities

General. The principal lending activities of the Bank are the origination of residential mortgage, commercial mortgage, commercial business and consumer loans. Generally, loans are originated in the Bank's primary market area.

One-to-Four Family Mortgage Loans. The Bank offers first mortgage loans secured by one-to-four family residences located in the Bank's primary lending area. Typically such residences are single-family owner occupied units. The Bank is an approved, qualified lender for the Federal Home Loan Mortgage Corporation (FHLMC). As a result, the Bank may sell loans to and service loans for the FHLMC in market conditions and circumstances where this is advantageous in managing interest rate risk.

Home Equity Loans. The Bank originates home equity loans secured by single-family residences. These loans may be either a single advance fixed-rate loan with a term of up to 15 years, or a variable rate revolving line of credit. These loans are made only on owner-occupied single-family residences.

Commercial and Commercial Real Estate Loans. Commercial lending constitutes a significant portion of the Bank's lending activities comprising a combined total of 37.3% of the total loan portfolio at December 31, 2003. Commercial real estate loans generally consist of loans granted for commercial purposes secured by commercial or other nonresidential real estate. Commercial loans consist of secured and unsecured loans for such items as capital assets, inventory, operations and other commercial purposes.

Consumer Loans. Consumer loans generally consist of fixed-rate term loans for automobile purchases, home improvements not secured by real estate, capital and

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other personal expenditures. In addition, the Bank funds education loans, under various government guaranteed student loan programs, that are serviced for the Bank by a third party. The Bank also offers unsecured revolving personal lines of credit and overdraft protection.

Loans to One Borrower. National banks are subject to limits on the amount of credit that they can extend to one borrower. Under current law, loans to one borrower are limited to an amount equal to 15% of unimpaired capital and surplus on an unsecured basis, and an additional amount equal to 10% of unimpaired capital and surplus if the loan is secured by readily marketable collateral. At December 31, 2003, the Bank's loans to one borrower limit based upon 15% of unimpaired capital was \$3.0 million. At December 31, 2003, the Bank's largest single lending relationship had an outstanding balance of \$5.0 million, which consisted of a loan to a municipality and was not subject to the legal lending limit. The next largest aggregate borrower had loans which totaled \$2.6 million and consisted of loans secured by commercial real estate and business property in the Bank's lending area, and was performing in accordance with its terms.

Loan Portfolio. The following table sets forth the composition and percentage of the Corporation's loans receivable in dollar amounts and in percentages of the portfolio as of December 31:

| (Dollar amounts in thousands) | 2003 | | 2002 | | 2001 | | 2000 |
|--------------------------------|------------------|---------------|------------------|---------------|------------------|---------------|------------------|
| | Dollar Amount | % | Dollar Amount | % | Dollar Amount | % | Dollar Amount |
| Mortgage loans: | | | | | | | |
| Consumer | \$106,712 | 55.5% | \$101,585 | 59.4% | \$100,420 | 62.0% | \$92,429 |
| Commercial | 44,935 | 23.4% | 34,986 | 20.4% | 26,470 | 16.3% | 24,661 |
| Total real estate loans | 151,647 | 78.9% | 136,571 | 79.8% | 126,890 | 78.3% | 117,090 |
| Other loans: | | | | | | | |
| Commercial business | 26,470 | 13.9% | 21,913 | 12.8% | 20,806 | 12.9% | 20,084 |
| Consumer | 14,142 | 7.4% | 12,660 | 7.4% | 14,308 | 8.8% | 14,618 |
| Total other loans | 40,612 | 21.1% | 34,573 | 20.2% | 35,114 | 21.7% | 34,702 |
| Total loans receivable | 192,259 | 100.0% | 171,144 | 100.0% | 162,004 | 100.0% | 151,792 |
| Less: | | | | | | | |
| Allowance for loan losses | 1,777 | | 1,587 | | 1,464 | | 1,460 |
| Net loans receivable | \$190,482 | | \$169,557 | | \$160,540 | | \$150,332 |

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The following table sets forth the scheduled contractual principal repayments or interest repricing of loans in the Corporation's portfolio as of December 31, 2003. Demand loans having no stated schedule of repayment and no stated maturity are reported as due within one year.

| (Dollar amounts in thousands) | Due in one year or less | Due from one to five years | Due from five to ten years | Due after ten years | Total |
|-------------------------------|-------------------------|----------------------------|----------------------------|---------------------|------------------|
| Consumer mortgage | \$7,603 | \$20,493 | \$25,008 | \$53,608 | \$106,712 |
| Commercial mortgage | 4,292 | 18,395 | 17,378 | 4,870 | 44,935 |
| Commercial business | 10,356 | 7,917 | 2,011 | 6,186 | 26,460 |
| Consumer | 6,802 | 6,072 | 1,240 | 28 | 14,142 |
| | <u>\$29,053</u> | <u>\$52,877</u> | <u>\$45,637</u> | <u>\$64,692</u> | <u>\$192,259</u> |

The following table sets forth the dollar amount of the Corporation's fixed- and adjustable-rate loans with maturities greater than one year as of December 31, 2003:

Loans Maturing Over One Year

| (Dollar amounts in thousands) | Fixed rates | Adjustable rates |
|-------------------------------|------------------|------------------|
| Consumer mortgage | \$98,081 | \$1,000 |
| Commercial mortgage | 11,747 | 28,800 |
| Commercial business | 12,796 | 3,300 |
| Consumer | 7,340 | |
| | <u>\$129,964</u> | <u>\$33,200</u> |

Contractual maturities of loans do not reflect the actual term of the Corporation's loan portfolio. The average life of mortgage loans is substantially less than their contractual terms because of loan prepayments and enforcement of due-on-sale clauses, which give the Corporation the right to declare a loan immediately payable in the event, among other things, that the

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borrower sells the real property subject to the mortgage. Scheduled principal amortization also reduces the average life of the loan portfolio. The average life of mortgage loans tends to increase when current market mortgage rates substantially exceed rates on existing mortgages and conversely, decrease when rates on existing mortgages substantially exceed current market interest rates.

Delinquencies and Classified Assets

Delinquent Loans and Real Estate Acquired Through Foreclosure (REO). Typically, a loan is considered past due and a late charge is assessed when the borrower has not made a payment within fifteen days from the payment due date. When a borrower fails to make a required payment on a loan, the Corporation attempts to cure the deficiency by contacting the borrower. The initial contact with the borrower is made shortly after the seventeenth day following the due date for which a payment was not received. In most cases, delinquencies are cured promptly.

If the delinquency exceeds 60 days, the Corporation works with the borrower to set up a satisfactory repayment schedule. Typically loans are considered non-accruing upon reaching 90 days delinquency, although the Corporation may be receiving partial payments of interest and partial repayments of principal on such loans. When a loan is placed in non-accrual status, previously accrued but unpaid interest is deducted from interest income. The Corporation institutes foreclosure action on secured loans only if all other remedies have been exhausted. If an action to foreclose is instituted and the loan is not reinstated or paid in full, the property is sold at a judicial or trustee's sale at which the Corporation may be the buyer.

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value at the date of foreclosure establishing a new cost basis. After foreclosure, management periodically performs valuations and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in loss on foreclosed real estate. The Corporation generally attempts to sell its REO properties as soon as practical upon receipt of clear title. The original lender typically handles disposition of those REO properties resulting from loans purchased in the secondary market.

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As of December 31, 2003, the Corporation's non-performing assets, which include non-accrual loans, loans delinquent due to maturity, troubled debt restructuring, repossessions and REO, amounted to \$1.4 million or 0.52% of the Corporation's total assets.

Classified Assets. Regulations applicable to insured institutions require the classification of problem assets as "substandard," "doubtful," or "loss" depending upon the existence of certain characteristics as discussed below. A category designated "special mention" must also be maintained for assets currently not requiring the above classifications but having potential weakness or risk characteristics that could result in future problems. An asset is classified as substandard if not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. A substandard asset is characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified as substandard. In addition, these weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly

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questionable and improbable. Assets classified as loss are considered uncollectible and of such little value that their continuance as assets is not warranted.

The Corporation's classification of assets policy requires the establishment of valuation allowances for loan losses in an amount deemed prudent by management. Valuation allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities. When the Corporation classifies a problem asset as a loss, the asset is charged-off immediately.

The Corporation regularly reviews the problem loans and other assets in its portfolio to determine whether any require classification in accordance with the Corporation's policy and applicable regulations. As of December 31, 2003, the Corporation's classified and criticized assets amounted to \$8.4 million with \$4.1 million classified as substandard and \$4.3 million identified as special mention.

The following table sets forth information regarding the Corporation's non-performing assets as of December 31:

| (Dollar amounts in thousands) | 2003 | 2002 | 2001 | 2000 |
|--|---------|---------|---------|---------|
| Non-performing loans | \$1,329 | \$1,160 | \$1,245 | \$900 |
| Total as a percentage of gross loans | 0.69% | 0.69% | 0.78% | 0.59% |
| Repossessions | 45 | - | - | - |
| Real estate acquired through foreclosure | - | 3 | 20 | 33 |
| Total as a percentage of total assets | 0.02% | 0.00% | 0.01% | 0.02% |
| Total non-performing assets | \$1,374 | \$1,163 | \$1,265 | \$933 |
| Total non-performing assets as a percentage of total assets | 0.52% | 0.49% | 0.58% | 0.48% |
| Allowance for loan losses as a percentage of non-performing loans | 133.71% | 136.81% | 117.59% | 162.22% |

Allowance for Loan Losses. Management establishes reserves for estimated losses on loans based upon its evaluation of the pertinent factors underlying the types and quality of loans; historical loss experience based on volume and types of loans; trend in portfolio volume and composition; level and trend on non-performing assets; detailed analysis of individual loans for which full collectibility may not be assured; determination of the existence and realizable value of the collateral and guarantees securing such loans; and the current economic conditions affecting the collectibility of loans in the portfolio. The Corporation analyzes its loan portfolio each month for valuation purposes and to

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determine the adequacy of its allowance for losses. Based upon the factors discussed above, management believes that the Corporation's allowance for losses as of December 31, 2003 of \$1.8 million is adequate to cover probable losses inherent in the portfolio.

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The following table sets forth an analysis of the allowance for losses on loans receivable for the years ended December 31:

| (Dollar amounts in thousands) | 2003 | 2002 | 2001 | 2000 | 1999 |
|---|---------|---------|---------|---------|---------|
| Balance at beginning of period | \$1,587 | \$1,464 | \$1,460 | \$1,373 | \$1,336 |
| Provision for loan losses | 330 | 381 | 154 | 209 | 162 |
| Charge-offs: | | | | | |
| Mortgage loans | (25) | (36) | (27) | (34) | (12) |
| Commercial business loans | (26) | (186) | (62) | (1) | - |
| Consumer loans | (154) | (109) | (108) | (121) | (143) |
| | (205) | (331) | (197) | (156) | (155) |
| Recoveries: | | | | | |
| Mortgage loans | - | 26 | - | - | - |
| Commercial business loans | 22 | 20 | - | 2 | - |
| Consumer loans | 43 | 27 | 47 | 32 | 30 |
| | 65 | 73 | 47 | 34 | 30 |
| Balance at end of period | \$1,777 | \$1,587 | \$1,464 | \$1,460 | \$1,373 |
| Ratio of net charge-offs to average loans outstanding | 0.08% | 0.15% | 0.10% | 0.08% | 0.09% |
| Ratio of allowance to total loans at end of period | 0.92% | 0.93% | 0.90% | 0.96% | 0.98% |

Investment Portfolio

General. The Corporation maintains an investment portfolio of securities such as U.S. government and agency securities, state and municipal debt obligations, corporate notes and bonds, and to a lesser extent, mortgage-backed and equity securities. Management generally maintains an investment portfolio with relatively short maturities to minimize overall interest rate risk. However, at December 31, 2003 approximately \$14.7 million was invested in longer-term callable municipal securities, as part of strategy to moderate federal income taxes. The Bank has no investment with any one issuer in an amount greater than 10% of stockholders' equity.

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Investment decisions are made within policy guidelines established by the Board of Directors. This policy is aimed at maintaining a diversified investment portfolio, which complements the overall asset/liability and liquidity objectives of the Bank, while limiting the related credit risk to an acceptable level.

The following table sets forth certain information regarding the amortized cost, fair value, weighted average yields and contractual maturities of the Corporation's securities as of December 31, 2003:

| (Dollar amounts in thousands) | Due in 1 year or less | Due from 1 to 3 years | Due from 3 to 5 years | Due from 5 to 10 years | Due after 10 years | No schedul maturity |
|-------------------------------|-----------------------------|-----------------------------|--------------------------|---------------------------------|-----------------------|------------------------|
| ----- | | | | | | |
| U.S. Government securities | \$3,065 | \$3,494 | \$9,365 | \$2,971 | \$- | \$- |
| Mortgage-backed securities | - | - | 832 | 837 | 17 | - |
| Municipal securities | - | - | - | - | 15,491 | - |
| Corporate securities | 3,541 | 6,330 | - | - | - | - |
| Equity securities | - | - | - | - | - | 3,219 |
| | ----- | | | | | |
| Estimated Fair Value | \$6,606 | \$9,824 | \$10,197 | \$3,808 | \$15,508 | \$3,219 |
| | ===== | | | | | |
| Weighted average yield (1) | 5.92% | 3.60% | 2.85% | 4.04% | 7.11% | 4.67% |
| | ===== | | | | | |

(1) Weighted average yield is calculated based upon amortized cost.

For additional information regarding the Corporation's investment portfolio see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Notes to Consolidated Financial Statements" in the Annual Report incorporated herein by reference.

Sources of Funds

General. Deposits are the primary source of the Bank's funds for lending and investing activities. Secondary sources of funds are derived from loan repayments and investment maturities. Loan repayments can be considered a relatively stable funding source, while deposit activity is greatly influenced by interest rates and general market conditions. The Bank also has access to funds through credit facilities available from the FHLB. In addition, the Bank can obtain advances from the FRB discount window. For a description of the Bank's sources of funds, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Annual Report incorporated herein by reference.

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Deposits. The Bank offers a wide variety of retail deposit account products to both consumer and commercial deposit customers, including time deposits, non-interest bearing and interest bearing demand deposit accounts, savings deposits and money market accounts.

Deposit products are promoted in periodic newspaper and radio advertisements, along with notices provided in customer account statements. The Bank's market strategy is based on its reputation as a community bank that provides quality products and personal customer service.

The Bank pays interest rates on its interest bearing deposit products that are competitive with rates offered by other financial institutions in its market area. Management reviews interest rates on deposits weekly and considers a number of factors, including (1) the Bank's internal cost of funds; (2) rates offered by competing financial institutions; (3) investing and lending opportunities; and (4) the Bank's liquidity position.

For additional information regarding the Corporation's deposit base and borrowed funds, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Notes to Consolidated Financial Statements" in the Annual Report incorporated herein by reference.

Subsidiary Activity

The Corporation has one wholly owned subsidiary, the Bank, a national association. As of December 31, 2003, the Bank had no subsidiaries.

Personnel

At December 31, 2003, the Bank had 98 full time equivalent employees. There is no collective bargaining agreement between the Bank and its employees, and the Bank believes its relationship with its employees to be satisfactory.

Competition

The Bank competes for loans, deposits and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions and other nonbank financial service providers.

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Risk Factors

The following discusses certain factors that may affect the Corporation's financial condition and results of operations and should be considered in evaluating the Corporation.

Ability Of The Corporation To Execute Its Business Strategy. The financial performance and profitability of the Corporation will depend, in large part, on its ability to favorably execute its business strategy. This execution entails risks in, among other areas, technology implementation, market segmentation, brand identification, banking operations, and capital and human resource investments. Accordingly, there can be no assurance that the Corporation will be successful in its business strategy.

Economic Conditions And Geographic Concentration. The Corporation's operations are located in western Pennsylvania and are concentrated in Venango, Clarion and

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Butler Counties, Pennsylvania. Although management has diversified the Corporation's loan portfolio into other Pennsylvania counties, and to a very limited extent into other states, the vast majority of the Corporation's credits remain concentrated in the three primary counties. As a result of this geographic concentration, the Corporation's results depend largely upon economic and real estate market conditions in these areas. Deterioration in economic or real estate market conditions in the Corporation's primary market areas could have a material adverse impact on the quality of the Corporation's loan portfolio, the demand for its products and services, and its financial condition and results of operations.

Interest Rates. By nature, all financial institutions are impacted by changing interest rates, due to the impact of such upon:

- the demand for new loans
- prepayment speeds experienced on various asset classes, particularly residential mortgage loans
- credit profiles of existing borrowers rates received on loans and securities
- rates paid on deposits and borrowings.

As presented previously, the Corporation is financially exposed to parallel shifts in general market interest rates, changes in the relative pricing of the term structure of general market interest rates, and relative credit spreads. Therefore, significant fluctuations in interest rates may present an adverse effect upon the Corporation's financial condition and results of operations.

Government Regulation And Monetary Policy. The financial services industry is subject to extensive federal and state supervision and regulation. Significant new laws, changes in existing laws, or repeals of present laws could cause the Corporation's financial results to materially differ from past results. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions for the Corporation, and a material change in these conditions could present an adverse impact on the Corporation's financial condition and results of operations.

Competition. The financial services business in the Corporation's market areas is highly competitive, and is becoming more so due to technological advances (particularly Internet based financial services delivery), changes in the regulatory environment, and the enormous consolidation that has occurred among financial services providers. Many of the Corporation's competitors are much larger in terms of total assets and market capitalization, enjoy greater liquidity in their equity securities, have greater access to capital and funding, and offer a broader array of financial products and services. In light of this environment, there can be no assurance that the Corporation will be able to compete effectively. The results of the Corporation may materially differ in future periods depending upon the nature or level of competition.

Credit Quality. A significant source of risk arises from the possibility that losses will be sustained because borrowers, guarantors, and related parties may fail to perform in accordance with the terms of their loans. The Corporation has adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believes are appropriate to control this risk by assessing the likelihood of non-performance, tracking loan performance, and diversifying the credit portfolio. Such policies and procedures may not, however, prevent unexpected losses that could have a material adverse effect on the Corporation's financial condition or results of operations. Unexpected losses may arise from a wide variety of specific or systemic factors, many of which are beyond the

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Corporation's ability to predict, influence, or control.

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Other Risks. From time to time, the Corporation details other risks with respect to its business and financial results in its filings with the SEC.

Supervision and Regulation

General. Bank holding companies and banks are extensively regulated under both federal and state law. Set forth below is a summary description of certain provisions of certain laws that relate to the regulation of the Corporation and the Bank. The description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

The Corporation. The Corporation is a registered bank holding company, and subject to regulation and examination by the FRB under the Bank Holding Company Act of 1956, as amended (the "BHCA"). The Corporation is required to file with the FRB periodic reports and such additional information as the FRB may require.

The FRB may require the Corporation to terminate an activity or terminate control of or liquidate or divest certain subsidiaries, affiliates or investments when the FRB believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any of its banking subsidiaries. The FRB also has the authority to regulate provisions of certain bank holding company debt, including the authority to impose interest ceilings and reserve requirements on such debt. Under certain circumstances, the Corporation must file written notice and obtain FRB approval prior to purchasing or redeeming its equity securities.

Further, the Corporation is required by the FRB to maintain certain levels of capital. See "Capital Standards."

The Corporation is required to obtain prior FRB approval for the acquisition of more than 5% of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. Prior FRB approval is also required for the merger or consolidation of the Corporation and another bank holding company.

The Corporation is prohibited by the BHCA, except in certain statutorily prescribed instances, from acquiring direct or indirect ownership or control of more than 5% of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or furnishing services to its subsidiaries. However, subject to the prior FRB approval, The Corporation may engage in any, or acquire shares of companies engaged in, activities that the FRB deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Under FRB regulations, the Corporation is required to serve as a source of financial and managerial strength to the Corporation's subsidiary bank and may not conduct operations in an unsafe or unsound manner. In addition, it is the FRB's policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice

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or a violation of FRB regulations or both.

The Corporation is also a bank holding company within the meaning of the Pennsylvania Banking Code. As such, the Corporation and its subsidiaries are subject to examination by, and may be required to file reports with, the Pennsylvania Department of Banking.

The Corporation's securities are registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As such, the Corporation is subject to the information, proxy solicitation, insider trading, corporate governance, and other requirements and restrictions of the Exchange Act.

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The Bank. As a national banking association, the Bank is subject to primary supervision, examination and regulation by the Office of the Comptroller of the Currency (the "OCC"). The Corporation is also subject to regulations of the Federal Deposit Insurance Corporation ("FDIC") as administrator of the Bank Insurance Fund ("BIF") and the FRB. If, as a result of an examination of the Bank, the OCC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of the Corporation's operations are unsatisfactory or that the Bank is violating or has violated any law or regulation, various remedies are available to the OCC. Such remedies include the power to enjoin "unsafe or unsound practices," to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the Bank's growth, to assess civil monetary penalties, and to remove officers and directors. The FDIC has similar enforcement authority, in addition to its authority to terminate the Bank's deposit insurance in the absence of action by the OCC and upon a finding that the Bank is operating in an unsafe or unsound condition, is engaging in unsafe or unsound activities, or that the Corporation's conduct poses a risk to the deposit insurance fund or may prejudice the interest of its depositors.

A national bank may have a financial subsidiary engaged in any activity authorized for national banks directly or certain permissible activities. Generally, a financial subsidiary is permitted to engage in activities that are "financial in nature" or incidental thereto, even though they are not permissible for the national bank itself. The definition of "financial in nature" includes, among other items, underwriting, dealing in or making a market in securities, including, for example, distributing shares of mutual funds. The subsidiary may not, however, engage as principal in underwriting insurance, issue annuities or engage in real estate development or investment or merchant banking.

The Sarbanes-Oxley Act of 2002. On July 30, 2002, President Bush signed into law The Sarbanes-Oxley Act of 2002. This new legislation addresses accounting oversight and corporate governance matters, including:

- o the creation of a five-member oversight board appointed by the Securities & Exchange Commission that will set standards for accountants and have investigative and disciplinary powers;
- o the prohibition of accounting firms from providing various types of consulting services to public clients and requiring accounting firms to rotate partners among public client assignments every five years;
- o increased penalties for financial crimes;

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- o expanded disclosure of corporate operations and internal controls and required executive certification of financial presentations;
- o increased requirements for board audit committees and their members;
- o enhanced controls on, and reporting of, insider trading; and
- o statutory separations between investment bankers and analysts.

The new legislation and its implementing regulations will result in increased costs of compliance, including certain outside professional costs.

USA Patriot Act of 2001. The USA Patriot Act of 2001 and its implementing regulations significantly expanded the anti-money laundering and financial transparency laws, including:

- o due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-US persons;
- o standards for verifying customer identification at account opening and maintaining expanded records;
- o rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering;

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- o reports by non-financial businesses filed with the U.S. Treasury Department for cash transactions exceeding \$10,000; and
- o suspicious activities reports securities by brokers and dealers if they believe a customer may be violating U.S. laws and regulations.

Fair and Accurate Credit Transactions Act. In December 2003, President Bush signed into law the Fair and Accurate Credit Transactions Act ("FACT Act") which sets new obligations for financial firms to help deter identity theft and give consumers more control of their credit data. It also reauthorizes a federal ban on state laws that interfere with corporate credit granting and marketing practices. The FRB and the Federal Trade Commission ("FTC") are required to draft regulations to implement the FACT Act. It is not possible at this time to determine the impact of such regulations that are to be drafted; however, the FRB and FTC recently announced that businesses will have until December 1, 2004 to comply with the new initiatives.

Privacy. Federal banking rules limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Pursuant to these rules, financial institutions must provide:

- o initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;
- o annual notices of their privacy policies to current customers;

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and

- o a reasonable method for customers to "opt out" of disclosures to nonaffiliated third parties.

These privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. The Corporation's privacy policies have been implemented in accordance with the law.

On December 22, 2003, the SEC issued the advance notice of proposed rulemaking along with the federal banking agencies and other government agencies seeking comment on whether they should consider amending current regulations "to allow or require financial institutions to provide alternative types of privacy notices, such as a short privacy notice, that would be easier for consumers to understand." The concept release lists more than 40 questions regarding which the agencies seek comment from the public, organized in the following categories: goals of a privacy notice, elements of a privacy notice, language of a privacy notice, format of a privacy notice, mandatory and permissible aspects of a privacy notice, costs and benefits of a short notice, and other categories.

Interagency Guidance on Response Programs to Protect Against Identity Theft. On August 12, 2003, the Federal bank and thrift regulatory agencies requested public comment on proposed guidance that would require financial institutions to develop programs to respond to incidents of unauthorized access to customer information, including procedures for notifying customers under certain circumstances. The proposed guidance:

- o interprets previously issued interagency customer information security guidelines that require financial institutions to implement information security programs designed to protect their customers' information; and
- o describes the components of a response program and sets a standard for providing notice to customers affected by unauthorized access to or use of customer information that could result in substantial harm or inconvenience to those customers, thereby reducing the risk of losses due to fraud or identity theft.

The Bank is not able at this time to determine the impact of any such proposed guidance on the Corporation's financial condition or results of operation.

Dividends and Other Transfers of Funds. Dividends from the Bank constitute the principal source of income to the Corporation. The Corporation is a legal entity separate and distinct from the Bank. The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends to the Corporation. In addition, the Bank's regulators have the authority to prohibit the Bank from paying dividends, depending upon the Bank's financial condition, if such payment is deemed to constitute an unsafe or unsound practice.

Transactions with Affiliates. The Bank is subject to certain restrictions imposed by federal law on any extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of, any affiliates, the purchase of, or investments in, stock or other securities thereof, the taking of such securities as collateral for loans, and the purchase of assets of any affiliates. Such restrictions prevent any affiliates from borrowing from the Bank unless the loans are secured by marketable obligations of designated amounts. Further, such secured loans and investments by the Bank to or in any affiliate are limited,

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individually, to 10.0% of the Bank's capital and surplus (as defined by federal regulations), and such secured loans and investments are limited, in the aggregate, to 20.0% of the Bank's capital and surplus. Some of the entities included in the definition of an affiliate are parent companies, sister banks, sponsored and advised companies, investment companies whereby the Bank or its affiliate serves as investment advisor, and financial subsidiaries of the bank. Additional restrictions on transactions with affiliates may be imposed on the Bank under the prompt corrective action provisions of federal law. See "Prompt Corrective Action and Other Enforcement Mechanisms."

Loans-to-One Borrower Limitations. With certain limited exceptions, the maximum amount that a national bank may lend to any borrower (including certain related entities of the borrower) at one time may not exceed 15% of the unimpaired capital and surplus of the institution, plus an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral. At December 31, 2003, the Bank's loans-to-one-borrower limit was \$3.0 million based upon the 15% of unimpaired capital and surplus measurement. At December 31, 2003, the Bank's largest single lending relationship had an outstanding balance of \$5.0 million, which consisted of a loan to a municipality and was not subject to the legal lending limit. The next largest aggregate borrower had loans which totaled \$2.6 million and consisted of loans secured by commercial real estate and business property in the Bank's lending area, and was performing in accordance with its terms.

Capital Standards. The federal banking agencies have adopted risk-based minimum capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off-balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as federal banking agencies, to 100% for assets with relatively high credit risk.

The risk-based capital ratio is determined by classifying assets and certain off-balance sheet financial instruments into weighted categories, with higher levels of capital being required for those categories perceived as representing greater risk. Under the capital guidelines, a banking organization's total capital is divided into tiers. "Tier I capital" consists of (1) common equity, (2) qualifying noncumulative perpetual preferred stock, (3) a limited amount of qualifying cumulative perpetual preferred stock and (4) minority interests in the equity accounts of consolidated subsidiaries (including trust-preferred securities), less goodwill and certain other intangible assets. Not more than 25% of qualifying Tier I capital may consist of trust-preferred securities. "Tier II capital" consists of hybrid capital instruments, perpetual debt, mandatory convertible debt securities, a limited amount of subordinated debt, preferred stock that does not qualify as Tier I capital, a limited amount of the allowance for loan and lease losses and a limited amount of unrealized holding gains on equity securities. "Tier III capital" consists of qualifying unsecured subordinated debt. The sum of Tier II and Tier III capital may not exceed the amount of Tier I capital.

The guidelines require a minimum ratio of qualifying total capital to risk-adjusted assets of 8% and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4%. In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets must be 3%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators

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have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

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In addition, federal banking regulators may set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets.

Prompt Corrective Action and Other Enforcement Mechanisms. Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall below one or more prescribed minimum capital ratios. Each federal banking agency has promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At December 31, 2003, the Bank exceeded the required ratios for classification as "well/adequately capitalized."

An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The federal banking agencies, however, may not treat a significantly undercapitalized institution as critically undercapitalized unless its capital ratio actually warrants such treatment.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Finally, pursuant to an interagency agreement, the FDIC can examine any institution that has a substandard regulatory examination score or is considered undercapitalized - without the express permission of the institution's primary regulator.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines designed to assist the federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to: (i) internal controls, information systems and internal audit systems, (ii) loan documentation, (iii) credit underwriting, (iv) asset growth, (v) earnings, and (vi) compensation, fees and benefits. In addition, the federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets, (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses, (iii) compare problem asset totals to capital, (iv) take appropriate corrective action to resolve problem assets, (v) consider the size and potential risks of material

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asset concentrations, and (vi) provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk. These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

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Premiums for Deposit Insurance. Through the BIF, the FDIC insures the Bank's customer deposits up to prescribed limits for each depositor. The amount of FDIC assessments paid by each BIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other factors. Specifically, the assessment rate is based on the institution's capitalization risk category and supervisory subgroup category. An institution's capitalization risk category is based on the FDIC's determination of whether the institution is well capitalized, adequately capitalized or less than adequately capitalized. An institution's supervisory subgroup category is based on the FDIC's assessment of the financial condition of the institution and the probability that FDIC intervention or other corrective action will be required.

FDIC-insured depository institutions pay an assessment rate equal to the rate assessed on deposits insured by the Savings Association Insurance Fund ("SAIF").

The assessment rate currently ranges from zero to 27 cents per \$100 of domestic deposits. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis. Due to continued growth in deposits and some recent bank failures, the BIF is nearing its minimum ratio of 1.25% of insured deposits as mandated by law. If the ratio drops below 1.25%, it is likely the FDIC will be required to assess premiums on all banks. Any increase in assessments or the assessment rate could have a material adverse effect on the Corporation's earnings, depending on the amount of the increase. Furthermore, the FDIC is authorized to raise insurance premiums under certain circumstances.

The FDIC is authorized to terminate a depository institution's deposit insurance upon a finding by the FDIC that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the Bank could have a material adverse effect on the Corporation's earnings, depending on the collective size of the particular institutions involved.

All FDIC-insured depository institutions must pay an annual assessment to provide funds for the payment of interest on bonds issued by the Financing Corporation, a federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds, commonly referred to as FICO bonds, were issued to capitalize the Federal Savings and Loan Insurance Corporation. The FICO assessment rates for fourth quarter of fiscal 2003 were 1.54 cents for each \$100 of assessable deposits. The FICO assessments are adjusted quarterly to reflect changes in the assessment bases of the FDIC's insurance funds and do not vary depending on a depository institution's capitalization or supervisory evaluations.

Interstate Banking and Branching. Banks have the ability, subject to certain State restrictions, to acquire, by acquisition or merger, branches outside its home state. The establishment of new interstate branches is also possible in those states with laws that expressly permit it. Interstate branches are subject to certain laws of the states in which they are located. Competition may increase further as banks branch across state lines and enter new markets.

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Community Reinvestment Act and Fair Lending Developments. The Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act activities. The CRA generally requires the federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of its local communities, including low- and moderate-income neighborhoods. A bank may be subject to substantial penalties and corrective measures for a violation of certain fair lending laws. The federal banking agencies may take compliance with such laws and CRA obligations into account when regulating and supervising other activities. Furthermore, financial institutions are subject to annual reporting and public disclosure requirements for certain written agreements that are entered into between insured depository institutions or their affiliates and non-governmental entities or persons that are made pursuant to, or in connection with, the fulfillment of the CRA.

On February 6, 2004, the federal banking agencies proposed amendments to the CRA regulations that would:

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- o increase the definition of "small institution" from total assets of \$250 million to \$500 million, without regard to any holding company; and
- o take into account abusive lending practices by a bank or its affiliates in determining a bank's CRA rating.

A bank's compliance with its CRA obligations is based on a performance-based evaluation system which bases CRA ratings on an institution's lending service and investment performance. When a bank applies for approval to acquire another bank, the banking regulators will review the assessment of each subsidiary bank of the applicant bank holding company, and such records may be the basis for denying the application. The Bank's most recent CRA exam on March 22, 1999 resulted in a rating of satisfactory.

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank of Pittsburgh. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. As an FHLB member, the Bank, similar to current requirements, would be required to own capital stock in the FHLB in an amount equal to a percentage of our loans and borrowings. The new capital stock is redeemable on five years' written notice, subject to certain conditions.

The Corporation does not believe that the initial implementation of the FHLB-Pittsburgh new capital plan as approved will have a material impact upon its financial condition, cash flows, or results of operations. However, the Bank could be required to purchase or sell capital stock at the discretion of the FHLB-Pittsburgh.

Federal Reserve System. The FRB requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking, NOW, and Super NOW checking accounts) and non-personal time deposits. At December 31, 2003, the Bank was in compliance with these requirements.

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Item 2. Description of Property

(a) Properties. The Corporation owns no real property but utilizes the main office of the Bank. The Corporation's and the Bank's executive offices are located at 612 Main Street, Emlenton, Pennsylvania. The Corporation pays no rent or other form of consideration for the use of this facility. The following table sets forth information with respect to the Bank's offices at December 31, 2003:

| (Dollar amounts in thousands) | | | | |
|--|------------|-----------------|---------------------------|-------------------------------|
| Location | County | Owned or Leased | Lease Expiration Date (1) | Net Book Value or Annual Rent |
| Corporate and Bank Main Offices: | | | | |
| .. Headquarters and Main Office 612 Main Street, Emlenton, Pennsylvania 16373 | Venango | Owned | -- | \$1,533 |
| Data Center 708 Main Street, Emlenton, Pennsylvania 16373 | Venango | Owned | -- | 935 |
| Bank Branch Offices | | | | |
| Bon Aire Office 1101 North Main Street, Butler, Pennsylvania 16003 | Butler | Leased | May 2011 | 35 |
| Brookville Office 263 Main Street, Brookville, Pennsylvania 15825 | Jefferson | Owned | -- | 226 |
| Clarion Wood Street Office Sixth & Wood Street, Clarion, Pennsylvania 16214 | Clarion | Owned | -- | 355 |
| Clarion Mall Office (2) Room 400, Clarion Mall, Clarion, Pennsylvania 16214 | Clarion | Leased | March 2003 | 17 |
| DuBois Office 861 Beaver Drive, Dubois, Pennsylvania 15801 | Clearfield | Leased | June 2005 | 20 |
| East Brady Office 323 Kelly's Way, East Brady, Pennsylvania 16028 | Clarion | Owned | -- | 52 |
| Eau Claire Office 207 Washington Street, Eau Claire, Pennsylvania 16030 | Butler | Owned | -- | 152 |
| Knox Office Route 338 South, Knox, Pennsylvania 16232 | Clarion | Leased | December 2011 | 25 |

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| | | | | |
|--|--------|--------|------------------|-----|
| Meridian Office 101 Meridian Road, Butler, Pennsylvania 16003 | Butler | Leased | December 2012 | 26 |
| Ridgway Office 173 Main Street, Ridgway, Pennsylvania 15853 | Elk | Owned | -- | 150 |

-
- (1) Lease agreements for leased offices typically include renewal options.
 - (2) The Clarion Mall office was closed at the expiration of its lease in the first quarter 2003 and operations were consolidated with the Clarion Wood Street Office.

The Bank also maintains remote ATM facilities within its market area.

(b) Investment Policies. See "Item 1. Description of Business" above for a general description of the Bank's investment policies and any regulatory or Board of Directors' percentage of assets limitations regarding certain investments. All of the Bank's investment policies are reviewed and approved by the Board of Directors of the Bank, and such policies, subject to regulatory restrictions (if any), can be changed without a vote of stockholders. The Bank's investments are primarily acquired to produce income, and to a lesser extent, possible capital gains.

- (1) Investments in Real Estate or Interests in Real Estate. See "Item 1. Description of Business - Lending Activities," "Item 1. Description of Business - Supervision and Regulation of the Bank," and "Item 2. Description of Property - (a) Properties" above.

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- (2) Investments in Real Estate Mortgages. See "Item 1. Description of Business - Lending Activities" and "Item 1. Description of Business - Regulation of the Bank."

- (3) Investments in Securities of or Interests in Persons Primarily Engaged in Real Estate Activities. See "Item 1. Description of Business - Lending Activities," "Item 1. Description of Business - Supervision and Regulation of the Bank," and "Item 1. Description of Business - Subsidiary Activity."

(c) Description of Real Estate and Operating Data. Not Applicable.

Item 3. Legal Proceedings

Neither the Bank nor the Corporation is involved in any material legal proceedings. The Bank, from time to time, is party to litigation that arises in the ordinary course of business, such as claims to enforce liens, claims involving the origination and servicing of loans, and other issues related to the business of the Bank. In the opinion of management, the resolution of any such issues would not have a material adverse impact on the financial position,

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results of operation, or liquidity of the Bank or the Corporation.

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

No matters were submitted to stockholders for a vote during the quarter ended December 31, 2003.

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

The information is contained under the section captioned "Common Stock Information" in the Corporation's Annual Report for the fiscal year ended December 31, 2003, and is incorporated herein by reference. For information with respect to equity compensation plans, see "Item 11 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters."

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations

The required information is contained in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Corporation's Annual Report for the year ended December 31, 2003 and is incorporated herein by reference.

Item 7. Financial Statements

The Corporation's consolidated financial statements required herein are contained in the Corporation's Annual Report for the year ended December 31, 2003 and are incorporated herein by reference.

Item 8. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

Effective March 21, 2002, the Corporation replaced its independent auditors, S.R. Snodgrass, A.C. (S.R. Snodgrass) with Crowe Chizek and Company LLC (Crowe Chizek). S.R. Snodgrass' report on the Corporation's financial statements during the two most recent fiscal years preceding the date hereof contained no adverse opinion or disclaimer of opinions, and was not qualified or modified as to uncertainty, audit scope or accounting principles. The decision to change accountants was approved by the Corporation's Audit Committee. During the last two fiscal years and the subsequent interim period to the date hereof, there were no disagreements between the Corporation and S.R. Snodgrass on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreement(s), if not resolved to the satisfaction of S.R. Snodgrass, would have caused it to make a reference to the subject matter of the disagreement(s) in connection with its reports. None of the "reportable events" described in Item 304(a)(1)(v) of Regulation S-B occurred with respect to the Corporation within the last two fiscal years and the subsequent interim period to the date hereof.

During the two fiscal years and the subsequent interim period prior to March 21,

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2002, the Corporation did not consult Crowe Chizek regarding any of the matters or events set forth in Item 304(a)(2)(v) and (ii) of Regulation S-B.

Item 8A. 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 reports in compliance with the Securities Exchange Act of 1934, as amended ("Exchange Act"), is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms, and that such information is accumulated and communicated to the Corporation's Management, including its Chief Executive Officer and Principal Financial and Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls and procedures" in Rule 13a-14(c) promulgated under the Exchange Act. As of December 31, 2003, 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 the Corporation's Principal Financial and Accounting 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 Principal Financial and Accounting Officer concluded that the Corporation's disclosure controls and procedures were effective.

During the fourth quarter of fiscal year 2003, there were no significant changes in the Corporation's internal control over financial reporting or in other factors that could significantly affect the internal controls subsequent to the date of the evaluation referenced above.

PART III

Item 9. Directors and Executive Officers of the Registrant

The information contained under the sections captioned "Principal Beneficial Owners of the Corporation's Common Stock" and "Information as to Nominees, Directors and Executive Officers" is incorporated by reference to the Corporation's definitive proxy statement for the Corporation's Annual Meeting of Stockholders to be held on May 19, 2004 (the Proxy Statement) which will be filed no later than 120 days following the Corporation's fiscal year end.

The Corporation maintains a Code of Personal and Business Conduct and Ethics (the "Code") that applies to all employees, including the CEO and the principal financial and accounting officer. A copy of the Code is included as Exhibit 14 hereto. Any waiver of the Code with respect to the CEO and the principal financial and accounting officer will be publicly disclosed in accordance with applicable regulations.

Item 10. Executive Compensation

The information contained under the section captioned "Information as to Nominees, Directors and Executive Officers" in the Proxy Statement is incorporated herein by reference.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required by this item is incorporated herein by reference to the section captioned "Principal Beneficial Owners of the Corporation's Common

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Stock" in the Proxy Statement.

Item 12. Certain Relationships and Related Transactions

The information required by this item is incorporated herein by reference to the section captioned "Information as to Nominees, Directors and Executive Officers" in the Proxy Statement.

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Item 13. Exhibits, Lists and Reports on Form 8-K

(a) Exhibits are either attached as part of this Report or incorporated herein by reference.

- 3.1 Articles of Incorporation of Emclaire Financial Corp. (1)
- 3.2 Bylaws of Emclaire Financial Corp. (1)
- 4 Specimen Stock Certificate of Emclaire Financial Corp. (2)
- 10.1 Form of Change in Control Agreement between Registrant and two executive officers. (3)
- 10.2 Form of Group Term Carve-Out Plan between the Farmers National Bank of Emlenton and 20 Officers and Employees. (5)
- 10.3 Form of Supplemental Executive Retirement Plan Agreement between the Farmers National Bank of Emlenton and Six Officers. (5)
- 11 Statement regarding computation of earnings per share (see Note 1 of the Notes to Consolidated Financial Statements in the Annual Report).
- 13 Annual Report to Stockholders for the fiscal year ended December 31, 2003.
- 14 Code of Personal and Business Conduct and Ethics
- 31.1 CEO 302 Certification.
- 31.2 Principal Financial and Accounting Officer 302 Certification.
- 32.1 Chief Executive Officer 906 Certification.
- 32.2 Principal Financial and Accounting Officer 906 Certification.
- 20 Emclaire Financial Corp. Dividend Reinvestment and Stock Purchase Plan. (4)
- 21 Subsidiaries of the Registrant (see information contained herein under "Item 1. Description of Business - Subsidiary Activity").

(b) Reports on Form 8-K.

On October 17, 2003, the Corporation filed Form 8-K announcing earnings for the third quarter of fiscal year 2003.

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- (1) Incorporated by reference to the Registrant's Registration Statement on Form SB-2, as amended, (File No. 333-11773) declared effective by the SEC on October 25, 1996.
- (2) Incorporated by reference to the Registrant's Annual Report on Form 10-KSB for the year ended December 31, 1997.
- (3) Incorporated by reference to the Registrant's Annual Report on Form 10-KSB for the year ended December 31, 1996.
- (4) Incorporated by reference to the Registrant's Annual Report on Form 10-KSB for the year ended December 31, 2001.
- (5) Incorporated by reference to the Registrant's Annual Report on Form 10-KSB for the year ended December 31, 2002.

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Item 14. Principal Accountant Fees and Services.

The information required by this item is incorporated herein by reference to the section captioned "Ratification of Independent Public Accountants" in the Proxy Statement.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Dated: March 29, 2004

By: /s/ David L. Cox

David L. Cox
President, Chief Executive Officer, and Director
(Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ David L. Cox

David L. Cox
President, Chief Executive Officer, and Director
(Principal Executive Officer)

By: /s/ Shelly L. Rhoades

Shelly L. Rhoades
Treasurer
(Principal Financial and Accounting Officer)

Date: March 29, 2004

Date: March 29, 2004

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By: /s/ Ronald L. Ashbaugh

Ronald L. Ashbaugh
Director

Date: March 29, 2004

By: /s/ Brian C. McCarrier

Brian C. McCarrier
Director

Date: March 29, 2004

By: /s/ Bernadette H. Crooks

Bernadette H. Crooks
Director

Date: March 29, 2004

By: /s/ George W. Freeman

George W. Freeman
Director

Date: March 29, 2004

By: /s/ Rodney C. Heeter

Rodney C. Heeter
Director

Date: March 29, 2004

By: /s/ Robert L. Hunter

Robert L. Hunter
Director

Date: March 29, 2004

By: /s/ J. Michael King

J. Michael King
Director

Date: March 29, 2004

By: /s/ John B. Mason

John B. Mason
Director

Date: March 29, 2004