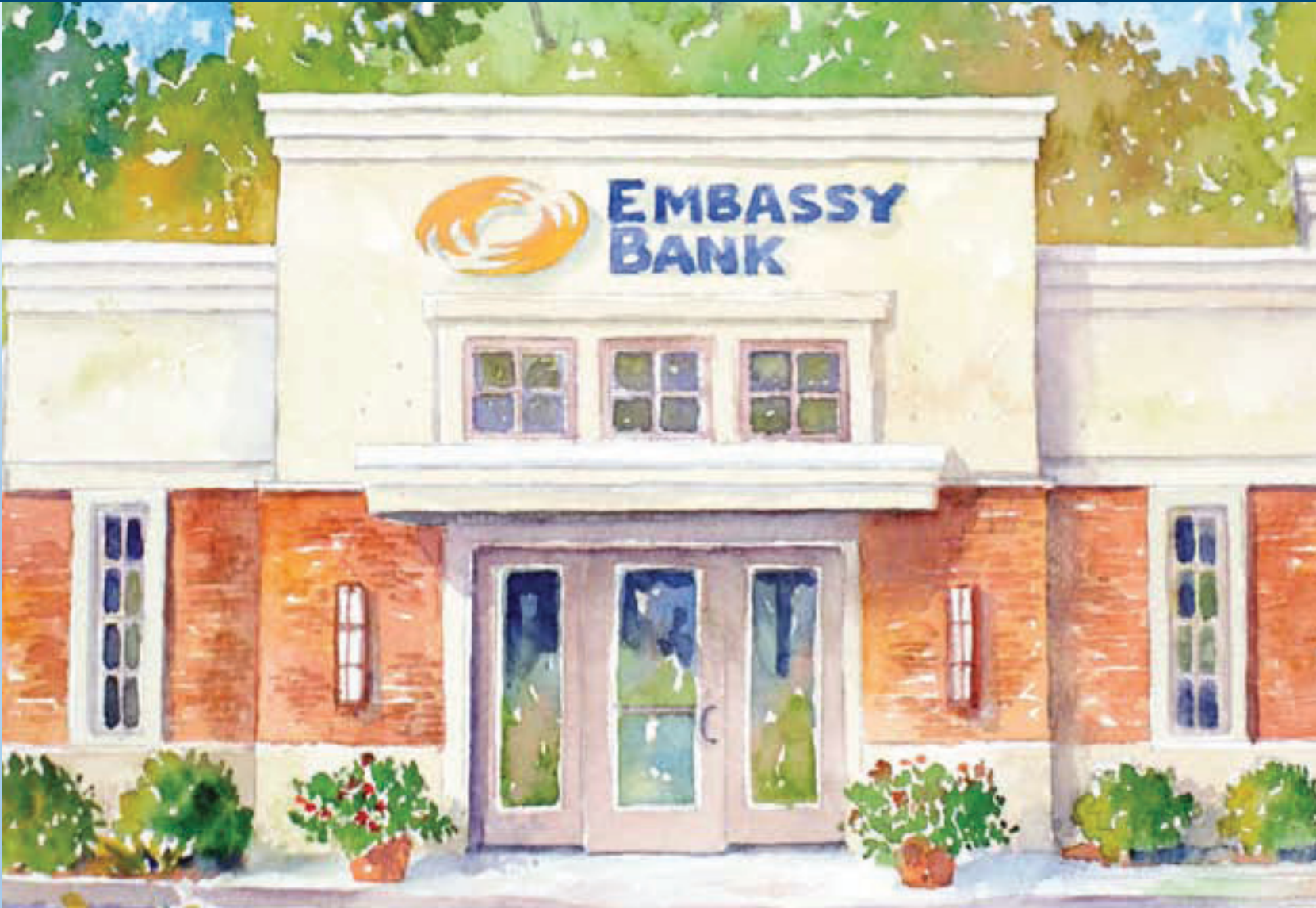




**EMBASSY  
BANCORP, INC.**



*2009*

ANNUAL REPORT

# ***Corporate Information***

## **Board of Directors**

### **Frank Banko**

*President, Warren Distributing  
Owner Banko Real Estate Company*

### **Geoffrey F. Boyer, CFP**

*President, Boyer Financial Group*

### **John P. Brew, Jr.**

*Chief Bank Strategist of m.rae resources, inc.  
CEO, BNK Advisory Group, Inc.*

### **Robert P. Daday**

*Retired PPL Executive*

### **John G. Engleson**

*Principal, zAxis*

### **Elmer D. Gates**

*Lead Director, Embassy Bancorp, Inc. and  
Embassy Bank for the Lehigh Valley*

### **M. Bernadette Holland, CFP**

*First Vice President  
Janney Montgomery Scott, LLC*

### **Bernard M. Lesavoy, Esquire**

*Member, Lesavoy Butz & Seitz LLC*

### **David M. Lobach, Jr.**

*Chairman of the Board, CEO & President  
Embassy Bancorp, Inc. and  
Embassy Bank for the Lehigh Valley*

### **John C. Pittman**

*Owner/CEO  
John C Pittman Sport Stars Inc.*

### **John T. Yurconic**

*President  
John Yurconic Agency*



## **Officers**

### **Executive Officers**

**David M. Lobach, Jr.**, *Chairman of the Board, CEO & President*

**Judith A. Hunsicker**, *Sr. Executive Vice President, COO, CFO, Secretary & Treasurer*

**James R. Bartholomew**, *Executive Vice President & SLO Commercial Lending*

### **Senior Vice Presidents**

**Tracy A. Barker**, *Deposit Operations & Human Resources*

**Desty A. Bonstein**, *Business Development*

**Mark A. Casciano**, *Branch Administration*

**Diane M. Cunningham**, *Consumer Lending*

**Lynne M. Neel**, *Controller & Credit Administration*

**Terry M. Stecker**, *Commercial Lending*

### **Vice Presidents**

**David C. Arner**, *Cash Management Services*

**Jeffrey A. Cella**, *Commercial Lending*

**Diane R. Effting**, *Commercial Lending*

**Scott A. Karwacki**, *Credit Analysis*

**Michael Lahanas**, *Business Development*

**Jane M. Rutt**, *Credit Administration*

**Timothy P. Woodbridge**, *Commercial Lending*

### **Assistant Vice Presidents**

**Michelle L. Barron**, *Deposit Operations*

**Tracy L. McCarthy**, *Credit Administration*

**Christine L. Pierce**, *Branch Administration*

**Rozanne M. Snyder**, *Assistant Controller*

**Brandi L. Stefanov**, *Branch Administration*

**Jennifer A. Tropeano**, *Consumer Lending*

**Kristin A. Wannisky**, *Marketing*

**Debra A. Young**, *Business Development*

### **Assistant Treasurers**

**Taryn M. Burgess**, *Branch Administration*

**Laura M. Chambers**, *Branch Administration*

**Molly A. Higgins**, *Operations Technology*

**Bryan D. Lobach**, *Commercial Services*

**Cynthia L. Morely**, *Commercial Lending*

**Maria P. Nace**, *Branch Administration*

**Angela M. O'Hara**, *Branch Administration*

**Lisa M. Schmidt**, *Commercial Lending*

**Heather Zoito**, *Branch Administration*

# ***Embassy Bancorp, Inc.***

Financial Report

December 31, 2009

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## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders  
Embassy Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Embassy Bancorp Inc. and its subsidiary, Embassy Bank for the Lehigh Valley, (collectively the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the two-year period ended December 31, 2009. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2009 and 2008, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "ParenteBeard LLC". The signature is written in a cursive, flowing style.

ParenteBeard LLC  
Allentown, Pennsylvania  
March 31, 2010

# Embassy Bancorp, Inc.

## Consolidated Balance Sheets

ASSETS	December 31,	
	2009	2008
	(In Thousands, Except Share and Per Share Data)	
Cash and due from banks	\$ 4,108	\$ 8,459
Interest bearing demand deposit with banks	13,981	20
Federal funds sold	8,375	3,575
	<hr/>	<hr/>
Cash and Cash Equivalents	26,464	12,054
Interest bearing time deposits	10,724	1,694
Securities available for sale	72,795	54,251
Restricted investment in bank stock	2,109	2,075
Loans receivable, net of allowance for loan losses of \$3,598 in 2009; \$2,932 in 2008	346,320	316,648
Premises and equipment, net of depreciation	2,465	2,231
Deferred income taxes	199	335
Accrued interest receivable	1,615	1,197
Other assets	2,498	598
	<hr/>	<hr/>
<b>Total Assets</b>	<b>\$ 465,189</b>	<b>\$ 391,083</b>
	<hr/>	<hr/>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Deposits:		
Non-interest bearing	\$ 25,785	\$ 16,194
Interest bearing	355,499	291,376
	<hr/>	<hr/>
Total Deposits	381,284	307,570
Securities sold under agreements to repurchase and federal funds purchased	30,964	26,019
Long-term borrowings	17,016	23,162
Accrued interest payable	1,457	2,563
Other liabilities	791	1,398
	<hr/>	<hr/>
<b>Total Liabilities</b>	<b>431,512</b>	<b>360,712</b>
Stockholders' Equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; 2009 issued 6,940,663 shares; outstanding 6,940,310 shares; 2008 issued 6,890,742 shares; outstanding 6,890,389 shares	6,941	6,891
Surplus	22,900	22,787
Accumulated earnings (deficit)	2,455	(278)
Accumulated other comprehensive income	1,384	974
Treasury stock, at cost, 353 shares	(3)	(3)
	<hr/>	<hr/>
<b>Total Stockholders' Equity</b>	<b>33,677</b>	<b>30,371</b>
	<hr/>	<hr/>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 465,189</b>	<b>\$ 391,083</b>
	<hr/>	<hr/>

See notes to consolidated financial statements.

# Embassy Bancorp, Inc.

## Consolidated Statements of Income

	Years Ended December 31,	
	2009	2008
	(In Thousands, Except per Share Data)	
<b>INTEREST INCOME</b>		
Loans receivable, including fees	\$ 19,444	\$ 18,272
Securities	3,042	2,346
Federal funds sold	30	29
Interest on time deposits	232	12
Other	7	5
<b>Total Interest Income</b>	<b>22,755</b>	<b>20,664</b>
<b>INTEREST EXPENSE</b>		
Deposits	7,619	9,315
Securities sold under agreements to repurchase and federal funds purchased	525	663
Short-term borrowings	17	410
Long-term borrowings	1,067	672
<b>Total Interest Expense</b>	<b>9,228</b>	<b>11,060</b>
<b>Net Interest Income</b>	<b>13,527</b>	<b>9,604</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>702</b>	<b>429</b>
<b>Net Interest Income after Provision for Loan Losses</b>	<b>12,825</b>	<b>9,175</b>
<b>OTHER INCOME</b>		
Credit card processing fees	560	381
Gain on sales of investment securities, net	174	-
Other service fees	312	280
<b>Total Other Income</b>	<b>1,046</b>	<b>661</b>
<b>OTHER EXPENSES</b>		
Salaries and employee benefits	4,295	3,792
Occupancy and equipment	1,607	1,268
Data processing	711	642
Credit card processing	520	366
Advertising and promotion	512	501
Professional fees	372	315
FDIC insurance	690	159
Insurance	83	66
Loan department	132	80
Charitable contributions	239	236
Other	774	567
<b>Total Other Expenses</b>	<b>9,935</b>	<b>7,992</b>
<b>Income before Income Taxes</b>	<b>3,936</b>	<b>1,844</b>
<b>INCOME TAX EXPENSE</b>	<b>1,203</b>	<b>658</b>
<b>Net Income</b>	<b>\$ 2,733</b>	<b>\$ 1,186</b>
<b>BASIC EARNINGS PER SHARE</b>	<b>\$ 0.40</b>	<b>\$ 0.17</b>
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 0.38</b>	<b>\$ 0.16</b>

See notes to consolidated financial statements.

# Embassy Bancorp, Inc.

## Consolidated Statements of Stockholders' Equity Years Ended December 31, 2009 and 2008

	Common Stock	Surplus	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Total
	(In Thousands, Except Share and Per Share Data)					
<b>BALANCE - DECEMBER 31, 2007</b>	\$ 6,886	\$ 22,775	\$ (1,464)	\$ 76	\$ -	\$ 28,273
Comprehensive income:						
Net income	-	-	1,186	-	-	1,186
Net change in unrealized gain on securities available for sale, net of income tax effects	-	-	-	898	-	898
<b>Total Comprehensive Income</b>						<u>2,084</u>
Exercise of stock options, 4,827 shares	5	12	-	-	-	17
Purchase treasury stock, 353 shares at \$9.73 per share	-	-	-	-	(3)	(3)
<b>BALANCE - DECEMBER 31, 2008</b>	<u>\$ 6,891</u>	<u>\$ 22,787</u>	<u>\$ (278)</u>	<u>\$ 974</u>	<u>\$ (3)</u>	<u>\$ 30,371</u>
<b>BALANCE - DECEMBER 31, 2008</b>	\$ 6,891	\$ 22,787	\$ (278)	\$ 974	\$ (3)	\$ 30,371
Comprehensive income:						
Net income	-	-	2,733	-	-	2,733
Net change in unrealized gain on securities available for sale, net of income tax effects	-	-	-	410	-	410
<b>Total Comprehensive Income</b>						<u>3,143</u>
Exercise of stock options, 49,921 shares	<u>50</u>	<u>113</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>163</u>
<b>BALANCE - DECEMBER 31, 2009</b>	<u>\$ 6,941</u>	<u>\$ 22,900</u>	<u>\$ 2,455</u>	<u>\$ 1,384</u>	<u>\$ (3)</u>	<u>\$ 33,677</u>

See notes to consolidated financial statements.

# Embassy Bancorp, Inc.

## Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2009	2008
	(In Thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 2,733	\$ 1,186
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	702	429
Amortization of deferred loan costs	138	171
Depreciation and amortization	475	407
Net amortization (accretion) of investment security premiums and discounts	55	(42)
Deferred income taxes	(75)	403
Net realized gain on sale of securities available for sale	(174)	-
Increase in accrued interest receivable	(418)	(59)
Increase in other assets	(1,900)	(62)
Decrease in accrued interest payable	(1,106)	(1,554)
(Decrease) increase in other liabilities	(607)	865
<b>Net Cash (Used in) Provided by Operating Activities</b>	<b>(177)</b>	<b>1,744</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of securities available for sale	(32,634)	(11,237)
Maturities, calls and principal repayments of securities available for sale	11,582	7,886
Proceeds from sales of securities available for sale	3,248	-
Net increase in loans	(30,512)	(42,935)
Increase in restricted investment in bank stock	(34)	(566)
Purchases of interest bearing time deposits	(9,030)	(1,694)
Purchases of premises and equipment	(709)	(176)
<b>Net Cash Used in Investing Activities</b>	<b>(58,089)</b>	<b>(48,722)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	73,714	40,929
Net increase in securities sold under agreements to repurchase and federal funds purchased	4,945	8,054
Decrease in short-term borrowed funds	-	(6,093)
Proceeds from long-term borrowed funds	4,250	12,766
Repayment of long-term borrowed funds	(10,396)	-
Proceeds from the exercise of stock options	163	17
Acquisition of treasury stock	-	(3)
<b>Net Cash Provided by Financing Activities</b>	<b>72,676</b>	<b>55,670</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>14,410</b>	<b>8,692</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING</b>	<b>12,054</b>	<b>3,362</b>
<b>CASH AND CASH EQUIVALENTS - ENDING</b>	<b>\$ 26,464</b>	<b>\$ 12,054</b>
<b>SUPPLEMENTARY CASH FLOWS INFORMATION</b>		
Interest paid	\$ 10,334	\$ 12,614
Income taxes paid	\$ 1,533	\$ 19

See notes to consolidated financial statements.

# ***Embassy Bancorp, Inc.***

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## **Notes to Consolidated Financial Statements**

### **Note 1 - Summary of Significant Accounting Policies**

#### **Principles of Consolidation and Nature of Operations**

The consolidated financial statements include the accounts of Embassy Bancorp, Inc. and its wholly owned subsidiary, Embassy Bank For the Lehigh Valley (collectively the “Company”). All intercompany accounts and transactions have been eliminated in consolidation. Embassy Bancorp, Inc. (the “Holding Company”) is a Pennsylvania corporation organized on November 11, 2008 and registered as a bank holding company pursuant to section 3(a)(1) of the Bank Holding Company Act of 1956, as amended (the “BHC Act”) and section 225.15 of Regulation Y. It owns all of the capital stock of Embassy Bank For the Lehigh Valley (the “Bank”), giving the Bank more flexibility in meeting its capital needs as the Bank continues to grow. Stockholders of the Bank exchanged each share of common stock of the Bank for one share of common stock of the Holding Company. The transaction was accounted for in a manner similar to the pooling-of-interests method of accounting. Accordingly, the financial information relating to periods prior to November 11, 2008 are reported under the name of Embassy Bancorp, Inc. The Company, as a holding company, is subject to regulations of the Federal Reserve Board.

The Bank was incorporated as a bank in Pennsylvania on May 11, 2001 and opened its doors on November 6, 2001. The Bank was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank’s market area. As a state chartered bank, the Bank is subject to regulation by the Pennsylvania Department of Banking and the FDIC.

#### **Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, and the valuation of deferred tax assets.

#### **Concentrations of Credit Risk**

Most of the Company’s activities are with customers located in the Lehigh Valley area of Pennsylvania. Note 2 discusses the types of securities in which the Company invests. The concentrations of credit by type of loan are set forth in Note 3. The Company does not have any significant concentrations to any one specific industry or customer, with the exception of lending activity to a broad range of lessors of residential and non-residential real estate within the Lehigh Valley. Although the Company has a diversified loan portfolio, its debtors’ ability to honor their contracts is influenced by the region’s economy.

#### **Presentation of Cash Flows**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing demand deposits with bank, and federal funds sold. Generally, federal funds are purchased or sold for less than one week periods.

#### **Securities**

Securities classified as available for sale are those securities that the Company intends to hold for an indefinite period of time but not necessarily to maturity. Securities available for sale are carried at fair value. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company’s assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

Effective April 1, 2009, the Company adopted new accounting guidance related to recognition and presentation of other-than-temporary impairment. This recent accounting guidance amends the recognition guidance for other-than-temporary impairments of debt securities and expands the financial statement disclosures for other-than-temporary impairment losses on debt and equity securities. The recent guidance replaced the “intent and ability” indication in current guidance by specifying that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. The Company recognized no other-than-temporary impairment charges during the years ended December 31, 2009 and 2008.

### **Restricted Investments in Bank Stock**

Restricted investments in bank stock consists of Federal Home Loan Bank stock (FHLB) and Atlantic Central Bankers Bank stock. Federal law requires a member institution of the FHLB to hold stock of its district FHLB according to a predetermined formula. The restricted stocks are carried at cost.

In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of capital stock. The Company had \$2.1 million of FHLB stock as of December 31, 2009.

Management evaluates the restricted stock for impairment. Management’s determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

Management believes no impairment charge is necessary related to the FHLB as of December 31, 2009.

### **Loans Receivable**

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Company is generally amortizing these amounts over the contractual life of the loan.

The accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management’s judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Allowance for Loan Losses**

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant change.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and home equity loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

#### **Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the following estimated useful lives of the related assets; furniture, fixtures and equipment for five to ten years, leasehold improvements for ten to fifteen years, computer equipment and data processing software for three to five years, and automobiles for five years.

#### **Transfers of Financial Assets**

Transfers of financial assets, including sales of loan participations, are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 1 - Summary of Significant Accounting Policies (Continued)

#### Advertising Costs

The Company follows the policy of charging the costs of advertising to expense as incurred.

#### Income Taxes

Deferred income taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and net operating loss carry forwards and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

#### Earnings per Share

Basic earnings per share represents net income divided by the weighted-average common shares outstanding during the period, as adjusted for stock splits. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares (stock options) had been issued. The following table sets forth the computations of basic and diluted earnings per share for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
	(Dollars In Thousands, Except Per Share Data)	
Net income	<u>\$ 2,733</u>	<u>\$ 1,186</u>
Weighted average shares outstanding	6,907,047	6,888,942
Dilutive effect of potential common shares, stock options	<u>371,269</u>	<u>436,664</u>
Diluted weighted average common shares outstanding	<u>7,278,316</u>	<u>7,325,606</u>
Basic earnings per share	<u>\$ 0.40</u>	<u>\$ 0.17</u>
Diluted earnings per share	<u>\$ 0.38</u>	<u>\$ 0.16</u>

#### Employee Benefit Plan

The Company has a 401(k) Plan (the "Plan") for employees. All employees are eligible to participate after they have attained the age of 21 and have also completed 12 consecutive months of service during which at least 1,000 hours of service are completed. The employees may contribute up to the maximum percentage allowable by law of their compensation to the Plan, and the Company provides a match of fifty percent of the first 8% percent to eligible participating employees. Full vesting in the Plan is prorated equally over a four-year period. The Company's contributions to the Plan for the years ended December 31, 2009 and 2008 were \$77 thousand and \$74 thousand, respectively.

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 1 - Summary of Significant Accounting Policies (Continued)

#### Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. Such financial instruments are recorded in the balance sheet when they are funded.

#### Comprehensive Income

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of the change in other comprehensive income are as follows for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Unrealized holding gains on available for sale securities	\$ 447	\$ 1,362
Less: reclassification adjustment for realized gains	<u>174</u>	<u>-</u>
	621	1,362
Tax effect	<u>(211)</u>	<u>(464)</u>
Net unrealized gains	<u>\$ 410</u>	<u>\$ 898</u>

#### Segment Reporting

The Company acts as an independent, community, financial services provider, and offers traditional banking and related financial services to individual, business and government customers. The Company offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer and home equity loans; and the provision of other financial services.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial and retail operations of the Company. As such, discrete financial information is not available and segment reporting would not be meaningful.

#### Stock-Based Compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of ASC 718, *Compensation-Stock Compensation*. ASC 718 requires compensation costs related to share-based payment transactions to be recognized in the financial statements over the period that an employee provides service in exchange for the award. For the years ended December 31, 2009 and 2008, there were no stock options granted.

#### Subsequent Events

Effective April 1, 2009, the Company adopted ASC Topic 855 *Subsequent Events*. This topic establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. This topic sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Subsequent Events (Continued)**

statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that should be made about events or transactions that occur after the balance sheet date.

#### **New Accounting Standards**

##### **ASC Topic 105**

In June 2009, the FASB issued ASC Topic 105, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162*. This topic replaces SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, to establish the *FASB Accounting Standards Codification* as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in preparation of financial statements in conformity with generally accepted accounting principles in the United States. This topic is effective for interim and annual periods ending after September 15, 2009. This guidance had no impact on the Company's consolidated financial statements upon adoption. Where applicable, all guidance in these financial statements refers to the codification references.

##### **ASU 2009-05**

In August 2009, the FASB issued 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 is effective for the first reporting period (including interim periods) beginning after issuance. The Company is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

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### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **New Accounting Standards (Continued)**

##### **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 Update is effective at the start of a reporting entity's first fiscal year beginning after November 15, 2009. Early application is not permitted. The Company is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

##### **ASU 2010-01**

In January 2010, the FASB issued ASU 2010-01, *Equity (Topic 505) - Accounting for Distributions to Shareholders with Components of Stock and Cash*. The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in earnings per share prospectively and is not a stock dividend. This Update codifies the consensus reached in EITF Issue No. 09-E, "Accounting for Stock Dividends, Including Distributions to Shareholders with Components of Stock and Cash."

This Update is effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The adoption of this pronouncement had no effect on the Company's consolidated financial statements.

##### **ASU 2010-06**

The FASB has 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.

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 1 - Summary of Significant Accounting Policies (Continued)

#### New Accounting Standards (Continued)

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 after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward 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. Early adoption is permitted. The Company is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

### Note 2 - Securities Available for Sale

The amortized cost and approximate fair values of securities available for sale are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In Thousands)			
<b>December 31, 2009:</b>				
U.S. Government agencies	\$ 16,583	\$ 500	\$ -	\$ 17,083
Municipal bonds	28,157	514	(97)	28,574
Mortgage-backed securities - residential	22,170	949	-	23,119
Corporate bonds	3,787	232	-	4,019
<b>Total</b>	<u>\$ 70,697</u>	<u>\$ 2,195</u>	<u>\$ (97)</u>	<u>\$ 72,795</u>
<b>December 31, 2008:</b>				
U.S. Government agencies	\$ 10,967	\$ 730	\$ -	\$ 11,697
Municipal bonds	5,485	26	(65)	5,446
Mortgage-backed securities - residential	36,322	800	(14)	37,108
<b>Total</b>	<u>\$ 52,774</u>	<u>\$ 1,556</u>	<u>\$ (79)</u>	<u>\$ 54,251</u>

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 2 - Securities Available for Sale (Continued)

The amortized cost and fair value of securities as of December 31, 2009 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In Thousands)	
Due in one year or less	\$ 8,993	\$ 9,246
Due after one year through five years	14,492	14,930
Due after five years through ten years	4,567	4,678
Due after ten years	<u>20,475</u>	<u>20,822</u>
	48,527	49,676
Mortgage-backed securities	<u>22,170</u>	<u>23,119</u>
	<u>\$ 70,697</u>	<u>\$ 72,795</u>

Three securities were sold during 2009 with fair values totaling \$3.1 million. Gross gains of \$185 thousand and gross losses of \$11 thousand were realized on the sales. There were no sales of securities during 2008.

The following table shows the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2009 and 2008:

	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair</u>	<u>Value</u>	<u>Unrealized Losses</u>	<u>Fair</u>	<u>Value</u>	<u>Unrealized Losses</u>
	(In Thousands)					
<b>December 31, 2009:</b>						
Municipal bonds	\$	2,860	\$	(97)	\$	(97)
<b>Total Temporarily Impaired Securities</b>	<u>\$</u>	<u>2,860</u>	<u>\$</u>	<u>(97)</u>	<u>\$</u>	<u>(97)</u>
<b>December 31, 2008:</b>						
Municipal bonds	\$	2,346	\$	(65)	\$	(65)
Mortgage-backed securities		3,719		(14)		(14)
<b>Total Temporarily Impaired Securities</b>	<u>\$</u>	<u>6,065</u>	<u>\$</u>	<u>(79)</u>	<u>\$</u>	<u>(79)</u>

The Company had 8 securities in an unrealized loss position at the end of December 31, 2009. Unrealized losses detailed above relate to municipal bonds and the decline in fair value is due only to interest rate fluctuations. No securities are deemed to be other than temporarily impaired. None of the individual unrealized losses are significant.

Securities with carrying values of approximately \$49.2 million and \$34.8 million at December 31, 2009 and 2008, respectively, were pledged as collateral to secure securities sold under agreements to repurchase, public deposits, and for other purposes required or permitted by law.

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 3 - Loans Receivable

The composition of loans receivable at December 31, 2009 and 2008 is as follows:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Commercial real estate	\$ 150,439	\$ 148,881
Commercial construction	12,292	6,886
Commercial	25,796	24,096
Home equity	159,180	136,739
Consumer	<u>2,160</u>	<u>2,726</u>
<b>Total Loans</b>	<b>349,867</b>	319,328
Unearned net loan origination costs	51	252
Allowance for Loan Losses	<u>(3,598)</u>	<u>(2,932)</u>
	<u><b>\$ 346,320</b></u>	<u><b>\$ 316,648</b></u>

### Note 4 - Allowance for Loan Losses

The changes in the allowance for loan losses for the years ended December 31, 2009 and 2008 are as follows:

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Loans receivable at end of year	<u><b>\$ 349,918</b></u>	<u><b>\$ 319,580</b></u>
Allowance for loan losses:		
Balance, beginning	\$ 2,932	\$ 2,503
Provision for loan losses	702	429
Loans charged off	(36)	-
Recoveries	-	-
Balance at end of year	<u><b>\$ 3,598</b></u>	<u><b>\$ 2,932</b></u>

At December 31, 2009 the recorded investment in impaired loans totaled \$4.8 million of which \$4.2 million required no allowance for loan losses. The recorded investment in impaired loans requiring an allowance for loan losses was \$595 thousand at December 31, 2009. At December 31, 2009 the related allowance for loan losses associated with those loans were \$267 thousand. At December 31, 2008 there were no loans impaired.

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

### **Note 4 - Allowance for Loan Losses (Continued)**

At December 31, 2009 the Company had five non-accrual loans of \$4.2 million and none for December 31, 2008. There were \$584 thousand and \$818 thousand of loans that were past due greater than 90 days or more and still accruing interest at December 31, 2009 and 2008, respectively. Finally, there was one loan in the amount of \$60 thousand that the Company considered impaired that was neither on non-accrual or was greater than 90 days past due. The average recorded investment in impaired loans was \$1.4 million for the year ended December 31, 2009 and interest income of \$26 thousand was recognized on impaired loans. Additional interest income of \$142 thousand would have been recognized for the year ended December 31, 2009 if the loans described above were not put on non-accrual.

### **Note 5 - Bank Premises and Equipment**

The components of premises and equipment at December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Furniture, fixtures and equipment	\$ 1,769	\$ 1,206
Leasehold improvements	1,788	1,528
Computer equipment and data processing software	841	640
Automobiles	92	92
Construction in progress	-	320
	<u>4,490</u>	<u>3,787</u>
Accumulated depreciation	<u>(2,025)</u>	<u>(1,556)</u>
	<u>\$ 2,465</u>	<u>\$ 2,231</u>

### **Note 6 - Deposits**

The components of deposits at December 31, 2009 and 2008 are as follows:

	<u>December 31, 2009</u>	<u>December 31, 2008</u>
	(In Thousands)	
Demand, non-interest bearing	\$ 25,785	\$ 16,194
Demand, NOW and money market, interest bearing	32,987	31,437
Savings	201,727	103,863
Time, \$100 and over	54,821	65,344
Time, other	<u>65,964</u>	<u>90,732</u>
Total deposits	<u>\$ 381,284</u>	<u>\$ 307,570</u>

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

### **Note 6 – Deposits (Continued)**

At December 31, 2009, the scheduled maturities of time deposits are as follows (in thousands):

2010	<b>\$89,686</b>
2011	<b>15,396</b>
2012	<b>12,425</b>
2013	<b>1,026</b>
2014	<b>2,252</b>
	<b><u>\$120,785</u></b>

### **Note 7 - Securities Sold under Agreements to Repurchase and Federal Funds Purchased**

Securities sold under agreements to repurchase and federal funds purchased generally mature within a few days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. Securities sold under these agreements are retained under the Company's control at its safekeeping agent. The Company may be required to provide additional collateral based on the fair value of the underlying securities. Information concerning securities sold under agreements to repurchase for the years ended December 31, 2009 and 2008 is summarized as follows:

	<b>2009</b>	<b>2008</b>
	(Dollars In Thousands)	
Balance outstanding at December 31	\$ <b>30,964</b>	\$ 26,019
Weighted average interest rate at the end of the year	<b>1.56 %</b>	2.68 %
Average daily balance during the year	\$ <b>27,866</b>	\$ 21,037
Weighted average interest rate during the year	<b>1.89 %</b>	3.10 %
Maximum month-end balance during the year	\$ <b>36,450</b>	\$ 26,019

### **Note 8 – Long-term Borrowings**

At December 31, 2009 the Company's maximum borrowing capacity with the FHLB was \$183.4 million. The Company had no short-term borrowings outstanding with the FHLB at December 31, 2009 and 2008. Long-term borrowings outstanding with the FHLB totaled \$11.4 million at December 31, 2009 and \$21.8 million at December 31, 2008.

The Company has two lines of credit with Univest National Bank and Trust Company ("Univest") totaling \$10 million. As of December 31, 2009 the outstanding balance was \$5.6 million and \$1.4 million at December 31, 2008. Advances from these lines of credit are secured by 833,333 shares of Bank stock. Under the terms of the loan agreement, the Bank is required to remain well capitalized. The proceeds of the loan were primarily used for the holding company's investment in the Bank, thus providing additional capital to support the Bank's growth.

The Company also has an open line of credit with the FHLB totaling \$25.0 million. The Company had no borrowings outstanding at December 31, 2009 and 2008, respectively for this credit line. Advances from the FHLB are secured by qualifying assets of the Company.

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 8 – Long-term Borrowings (Continued)

The Company has a federal fund line of credit facility with the Atlantic Central Bankers Bank totaling \$6.0 million. The Company had no borrowings outstanding at December 31, 2009 and 2008. Advances on this line are unsecured.

The components of long-term borrowings with the FHLB at December 31, 2009 and 2008 are as follows (in thousands):

Maturity Date	2009		2008	
	Interest Rate	Outstanding	Interest Rate	Outstanding
April 2009	-	\$ -	4.27%	\$ 1,850
August 2009	-	-	4.80%	1,428
January 2010	3.50%	2,000	3.50%	2,000
May 2010	-	-	4.75%	7,119
January 2012	3.23%	1,480	3.23%	1,479
June 2013	3.86%	4,834	3.86%	4,834
August 2013	3.98%	3,052	3.98%	3,052
		<u>\$ 11,366</u>		<u>\$ 21,762</u>

The components of long-term borrowings with Univest National Bank at December 31, 2009 and 2008 are as follows (in thousands):

Maturity Date	2009		2008	
	Interest Rate	Outstanding	Interest Rate	Outstanding
November 2015	7.50%	<u>\$ 5,650</u>	7.50%	<u>\$ 1,400</u>

### Note 9 - Lease Commitments

The Company has a ten-year operating lease agreement for its main banking office, which commenced in June 2002. The Company has the option to extend the lease agreement for five additional five-year periods. An addendum to this lease commenced in the second quarter 2005 for additional space. The Company is also required to pay a monthly fee for its portion of certain operating expenses, including real estate taxes, insurance, utilities, maintenance and repairs in addition to the base rent.

In November 2002, an investment group comprised of related parties of the Company (executive officers and directors) agreed to purchase the office building in which the Company leases office space as described above. The purchase was consummated on January 10, 2003. The initial lease terms for the Company's lease were negotiated at arm's length with the former owner in 2001. There were no modifications or amendments to the terms of that lease agreement by the new owners. The lease terms for the additional space in 2005 are comparable to similarly outfitted space in the Company's market. The beginning base rent under this agreement was \$19,569.00 per month.

The Company has a five-year operating lease agreement for its Tilghman Street site, which commenced in April 2004. The Company has the option to extend the lease agreement for four additional five-year periods. The Company is also required to pay a monthly fee for its portion of certain operating expenses, including real estate taxes, insurance,

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

### **Note 9 - Lease Commitments (Continued)**

utilities, maintenance and repairs in addition to the base rent. The beginning base rent under this agreement was \$6,585.00 per month.

In March 2006, the Company entered into a lease agreement with a related party of the Company (director) for a five-year operating lease agreement for its West Broad Street site, which commenced in September 2006. The Company has the option to extend the lease agreement for four additional five-year periods and a final renewal option of four years, eleven months. The beginning base rent under this agreement was \$3,750.00 per month.

In July 2005, the Company entered into a ground lease agreement for a branch location on S. Cedar Crest Boulevard in Allentown. The ground lease commenced in 2007. In March 2009, the Company committed to a lease agreement which terminates the ground lease agreement. This office occupies approximately 2,400 square feet of space at a beginning base rent of \$15,334.00 per month or \$76.67 per square foot. The branch opened in July 2009.

In October 2005, the Company entered into a seven year operating lease agreement for its Hamilton Boulevard branch location in Trexlertown, which commenced in January 2007. The Company has the option to extend the lease agreement for one additional five-year period and a final renewal option of four years, ten months. The Company is also required to pay a monthly fee for its portion of certain operating expenses, including real estate taxes, insurance, utilities, maintenance and repairs in addition to the base rent.

In June 2008, the Company entered into a lease for a branch location on Route 378 in Lower Saucon Township. This office occupies approximately 2,500 square feet of space at a beginning base rent of \$13,575.00 per month or \$65.16 per square foot. The lease commenced August 2009 and the branch opened in September 2009.

In December 2008, the Company entered into a ground lease agreement for a branch location on Corriere Road and Route 248 in Lower Nazareth Township. In October 2009, the Company committed to a lease agreement which terminates the ground lease agreement. The office occupies approximately 2,500 square feet of space at a beginning base rent of \$13,785.00 or \$66.17 per square foot. The lease commenced March 2010 and the branch is expected to open in the second quarter of 2010.

Future minimum lease payments by year and in the aggregate, under all lease agreements, are as follows (in thousands):

	<b>Related Parties</b>	<b>Third Parties</b>	<b>Total</b>
2010	\$ 317	\$ 567	\$ 884
2011	325	711	1,036
2012	168	730	898
2013	45	742	787
2014	45	702	747
Thereafter	75	3,800	3,875
	<u>\$ 975</u>	<u>\$ 7,252</u>	<u>\$ 8,227</u>

Total rent expense was \$735 thousand and \$578 thousand for the years ended December 31, 2009 and 2008, respectively. Rent expense to related parties was \$306 thousand for the years ended December 31, 2009 and 2008.

Rent expense to third parties was \$429 thousand and \$272 thousand for the years ended December 31, 2009 and 2008, respectively.

# ***Embassy Bancorp, Inc.***

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## **Notes to Consolidated Financial Statements**

### **Note 10 - Employment Agreements**

Employment agreements between the Company and the Company's Chief Executive Officer and Chief Operating Officer provide minimum annual salary, maximum bonuses, minimum stock options and change of control provisions. In addition, the terms of both employment agreements automatically renew annually for five year periods until each executive reaches the age of seventy (70). Upon resignation after a change in the control of the Company, as defined in the agreement, the individual will receive monetary compensation in the amount set forth in the agreement.

Employment agreement terms between the Company and the Company's Executive Vice President ("the EVP") providing change of control provisions were renegotiated on February 20, 2009. The Board of Directors of the Company approved the execution of an amended and restated employment agreement (the "Agreement") with the EVP of the Company, in order to provide for enhanced change in control provisions, and to replace the employment agreement dated July 16, 2004, between the EVP and the Bank, as subsequently amended on December 17, 2006. The Agreement provides for a three year term, with successive annual automatic one year extensions, such that there is never less than three years remaining on the Agreement, at such salary and bonuses as shall be agreed between the EVP and the Company.

### **Note 11 - Stockholders' Equity**

On November 11, 2008, the Company consummated its acquisition of Embassy Bank For The Lehigh Valley pursuant to a Plan of Merger and Reorganization dated April 18, 2008, pursuant to which the Bank was reorganized into a bank holding company structure. At the effective time of the reorganization, each share of common stock of Embassy Bank For The Lehigh Valley issued and outstanding was automatically converted into one share of Company common stock. The issuance of Company common stock in connection with the reorganization was exempt from registration pursuant to Section 3(a)(12) of the Securities Act of 1933, as amended.

### **Note 12 - Stock Option Plan**

In connection with the reorganization of the Bank into a holding company structure, the Company assumed the Bank's 2001 Stock Option Plan which was renamed the Embassy Bancorp, Inc. Option Plan (the "Plan"). The Plan authorizes the Board of Directors to grant options to officers, other employees and directors of the Company. As of March 31, 2010, the aggregate number of shares available for issuance under the Plan, as adjusted to reflect stock splits declared by the Bank's Board of Directors and an increase in the number of shares subject to the Plan approved by the Bank's shareholder prior to reorganization, is 1,263,645. The shares granted under the Plan to directors are non-qualified options. The shares granted under the Plan to officers and other employees are generally intended to be "incentive stock options," and are subject to the limitations under Section 422 of the Internal Revenue Code. Shares subject to options under the Plan may be either from authorized but unissued shares of the Company or shares purchased in the open market.

All options granted under the Plan are subject to vesting requirements of not less than three years and the term shall not exceed ten years. The exercise price of the options granted shall be the fair market value of a share of common stock at the time of the grant.

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 12 - Stock Option Plan (Continued)

The number of options and weighted average exercise prices have been adjusted to reflect the stock splits declared by the Bank in 2004, 2005, and 2007, prior to the reorganization. Transactions under the plan are summarized as follows:

	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding, December 31, 2007	917,818	\$ 3.81
Granted	-	-
Exercised	(4,827)	3.29
Forfeited	(3,317)	8.27
	<u>909,674</u>	<u>\$ 3.79</u>
<b>Outstanding, December 31, 2008</b>	<b>909,674</b>	<b>\$ 3.79</b>
<b>Granted</b>	<b>-</b>	<b>-</b>
<b>Exercised</b>	<b>(49,921)</b>	<b>3.26</b>
<b>Forfeited</b>	<b>(600)</b>	<b>10.00</b>
	<u>859,153</u>	<u>\$ 3.82</u>
<b>Outstanding, December 31, 2009</b>	<b>859,153</b>	<b>\$ 3.82</b>
	<u>859,153</u>	<u>\$ 3.82</u>
<b>Exercisable, December 31, 2009</b>	<b>859,153</b>	<b>\$ 3.82</b>

Stock options outstanding at December 31, 2009 are exercisable at prices ranging from \$2.84 to \$10.00 a share. The weighted-average remaining contractual life of options outstanding and exercisable at December 31, 2009 is 1.73 years. The weighted-average remaining contractual life of options outstanding and exercisable at December 31, 2008 is 2.72 years. At December 31, 2009, the aggregate intrinsic value of options outstanding and exercisable was \$3.4 million. The intrinsic value was determined by using the latest sales price of the Company's common stock on the open market. For the years ending December 31, 2009 and 2008, the aggregate intrinsic value of options exercised was \$165 thousand and \$32 thousand, respectively.

The following table summarizes information about the range of exercise prices for stock options outstanding at December 31, 2009:

<u>Range of Exercise Price</u>	<u>Weighted Average Exercise Price</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life (Years)</u>	<u>Number Exercisable</u>
\$2.00 to \$3.00	\$ 2.84	631,636	1.02	631,636
\$3.00 to \$4.00	3.91	93,356	2.52	93,356
\$6.00 to \$7.00	6.40	60,822	4.00	60,822
\$9.00 to \$10.00	10.00	73,339	5.00	73,339
		<u>859,153</u>	<u>1.73</u>	<u>859,153</u>

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 13 - Federal Income Taxes

The components of income tax expense for the years ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Current	\$ 1,128	\$ 1,061
Deferred	<u>75</u>	<u>(403)</u>
	<u>\$ 1,203</u>	<u>\$ 658</u>

A reconciliation of the statutory federal income tax at a rate of 34% to the income tax benefit included in the statement of income for the years ended December 31, 2009 and 2008 is as follows (in thousands):

	<u>2009</u>	<u>2008</u>
	(Dollars In Thousands)	
Federal income tax at statutory rate	\$ 1,338	\$ 627
Tax free interest	(164)	-
Other	<u>29</u>	<u>31</u>
	<u>\$ 1,203</u>	<u>\$ 658</u>

The Company adopted guidance in ASC Topic 740 regarding accounting for uncertainty in income taxes as of January 1, 2007. The Company has evaluated its tax positions. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that has a likelihood of being realized on examination of more than 50 percent. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. Under the “more likely than not” threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. As of January 1, 2008, December 31, 2008 and December 31, 2009 the Company had no material unrecognized tax benefits or accrued interest and penalties. The Company’s policy is to account for interest as a component of interest expense and penalties as a component of other expense. The Company is subject to U.S. federal income tax. Neither the Company nor the Bank, is subject to examination by U.S. Federal taxing authorities for years before 2006.

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

### **Note 13 – Federal Income Taxes (Continued)**

The components of the net deferred tax asset at December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 1,179	\$ 963
Contributions carryforward	237	191
Other	199	122
	<u>1,615</u>	<u>1,276</u>
<b>Total Deferred Tax Assets</b>	<b>1,615</b>	<b>1,276</b>
Deferred tax liabilities:		
Premises and equipment	169	48
Prepaid assets	153	168
Stock options	159	86
Cash basis conversion	68	136
Deferred loan costs	153	-
Unrealized gain on securities available for sale	714	503
	<u>1,416</u>	<u>941</u>
<b>Total Deferred Tax Liabilities</b>	<b>\$ 1,416</b>	<b>\$ 941</b>

Based upon the level of historical taxable income and projections for future taxable income over periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

### **Note 14 - Transactions with Executive Officers, Directors and Principal Stockholders**

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

Related parties were indebted to the Company for loans totaling \$3.2 million and \$3.7 million at December 31, 2009 and 2008, respectively. During 2009, loans totaling \$1.7 million were disbursed and loan repayments totaled \$2.2 million.

Fees paid to related parties for legal services for the years ended December 31, 2009 and 2008, were approximately \$42 thousand and \$24 thousand, respectively. The Company leases its main banking office from an investment group comprised of related parties and its West Broad Street office also from a related party as described in Note 9.

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

### **Note 15 - Financial Instruments with Off-Balance Sheet Risk**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

At December 31, 2009 and 2008, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Commitments to grant loans, fixed	\$ 7,537	\$ 311
Commitments to grant loans, variable	2,125	300
Unfunded commitments under lines of credit, fixed	3,519	886
Unfunded commitments under lines of credit, variable	48,602	43,000
Standby letters of credit	<u>3,599</u>	<u>2,743</u>
	<u>\$ 65,382</u>	<u>\$ 47,240</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at December 31, 2009 and 2008 was \$3.5 million and \$2.7 million, respectively, and the approximate value of underlying collateral upon liquidation that would be expected to cover this maximum potential exposure was \$3.0 million and \$2.7 million, respectively. The current amount of the liability as of December 31, 2009 and 2008 for guarantees under standby letters of credit issued is not material.

### **Note 16 - Regulatory Matters**

The Company is required to maintain cash reserve balances in vault cash and with the Federal Reserve Bank. As of December 31, 2009, the Company had a \$726 thousand minimum reserve balance, which was covered by vault cash.

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 16 – Regulatory Matters (Continued)

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary-actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2009, that the Company meets all capital adequacy requirements to which it is subject.

As of December 31, 2009, the most recent notification from the regulatory agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios at December 31, 2009 and 2008 are presented below:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollar Amounts in Thousands)						
<b>December 31, 2009:</b>						
Total capital (to risk-weighted assets)	\$ 41,062	12.8 %	\$ ≥ 25,642	≥ 8.0 %	\$ ≥ 32,052	≥ 10.0 %
Tier 1 capital (to risk-weighted assets)	37,464	11.7	≥ 12,821	≥ 4.0	≥ 19,231	≥ 6.0
Tier 1 capital (to average assets)	37,464	8.1	≥ 18,604	≥ 4.0	≥ 23,255	≥ 5.0
<b>December 31, 2008:</b>						
Total capital (to risk-weighted assets)	\$ 33,637	11.7 %	\$ ≥ 22,917	≥ 8.0 %	\$ ≥ 28,646	≥ 10.0 %
Tier 1 capital (to risk-weighted assets)	30,705	10.7	≥ 11,459	≥ 4.0	≥ 17,188	≥ 6.0
Tier 1 capital (to average assets)	30,705	8.1	≥ 15,260	≥ 4.0	≥ 19,075	≥ 5.0

The Bank is subject to certain restrictions on the amount of dividends that it may declare due to regulatory considerations. The Pennsylvania Banking Code provides that cash dividends may be declared and paid only out of accumulated net earnings.

The Federal Reserve Board approved a final rule in February 2006 that expands the definition of a small bank holding company ("BHC") under the Board's Small Bank Holding Company Policy Statement and the Board's risk-based and leverage capital guidelines for bank holding companies. In its revisions to the Policy Statement, the Federal Reserve Board has raised the small BHC asset size threshold from \$150 million to \$500 million and amended the related qualitative criteria for determining eligibility as a small BHC for the purposes of the policy statement and the capital guidelines. The policy statement facilitates the transfer of ownership of small community banks by permitting debt levels at small BHCs that are higher than what would typically be permitted for larger BHCs. Because small BHCs may, consistent with the policy statement, operate at a level of leverage that generally is inconsistent with the capital guidelines, the policy statement provides an exemption from such guidelines for small BHCs. Based on the policy

# ***Embassy Bancorp, Inc.***

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## **Notes to Consolidated Financial Statements**

### **Note 16 – Regulatory Matters (Continued)**

statement, Embassy Bancorp, Inc. meets the eligibility criteria of a small BHC and is exempt from regulatory capital requirements administered by the federal banking agencies.

Additionally, the Federal Reserve has indicated that a “small bank holding company” such as the Company, is not expected to pay corporate dividends until such time as its debt to equity ratio is 1:1 or less and its bank subsidiaries are otherwise well-managed, well-capitalized, and not under any supervisory order. The Company’s debt to equity ratio currently exceeds the aforementioned 1:1 ratio.

### **Note 17 - Fair Value of Financial Instruments**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures topic of FASB ASC, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company’s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The recent fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

ASC Topic 860 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 under ASC Topic 860 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’s 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.

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 17 - Fair Value of Financial Instruments (Continued)

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2009 and 2008 are as follows:

Description	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs	Total
	(In Thousands)			
December 31, 2009 Securities available for sale	\$ -	\$ 72,795	\$ -	\$ 72,795
December 31, 2008 Securities available for sale	\$ -	\$ 54,251	\$ -	\$ 54,251

For financial assets measured at fair value on a non-recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2009 and 2008 are as follows:

Description	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs	Total
	(In Thousands)			
December 31, 2009 Impaired loans	\$ -	\$ -	\$ 328	\$ 328
December 31, 2008 Impaired loans	\$ -	\$ -	\$ -	\$ -

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company'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 Company'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 Company's financial instruments at December 31, 2009 and 2008:

#### 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 values.

#### Interest Bearing Time Deposits (Carried at Cost)

Fair values for fixed-rate time certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits. The Company generally purchases amounts below the insured limit, limiting the amount of credit risk on these time deposits.

#### Securities Available for Sale (Carried at Fair Value)

The fair value 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

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

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### **Note 17 - Fair Value of Financial Instruments (Continued)**

#### **Securities Available for Sale (Carried at Fair Value) (Continued)**

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 securities, but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) were used to support fair values of certain Level 3 investments.

#### **Loans Receivable (Carried at Cost)**

The fair values of loans are estimated using discounted cash flow analyses, 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)**

Impaired loans are those that are accounted for under existing FASB guidance, in which the Bank has measured impairment 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.

#### **Restricted Investment in Bank Stock (Carried at Cost)**

The carrying amount of restricted investment in 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.

#### **Deposit Liabilities (Carried at Cost)**

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

#### **Securities Sold Under Agreements to Repurchase and Federal Funds Purchased (Carried at Cost)**

These borrowings are short term and the carrying amount approximates the fair value.

#### **Short-Term Borrowings (Carried at Cost)**

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

# Embassy Bancorp, Inc.

## Notes to Consolidated Financial Statements

### Note 17 - Fair Value of Financial Instruments (Continued)

#### Long-Term Borrowings (Carried at Cost)

Fair values of FHLB and Univest advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB and Univest 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 Financial Instruments (Disclosed at Cost)

Fair values for the Company'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.

The estimated fair values of the Company's financial instruments were as follows at December 31, 2009 and 2008:

	December 31, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In Thousands)			
Financial assets:				
Cash and cash equivalents	\$ 26,464	\$ 26,464	\$ 12,054	\$ 12,054
Interest bearing time deposits	10,724	10,857	1,694	1,694
Securities available-for-sale	72,795	72,795	54,251	54,251
Loans receivable, net of allowance	346,320	351,075	316,648	321,814
Restricted investments in bank stock	2,109	2,109	2,075	2,075
Accrued interest receivable	1,615	1,615	1,197	1,197
Financial liabilities:				
Deposits	381,284	373,087	307,570	316,726
Securities sold under agreements to repurchase and federal funds purchased	30,964	30,974	26,019	26,019
Long-term borrowings	17,016	17,197	23,162	24,203
Accrued interest payable	1,457	1,457	2,563	2,563
Off-balance sheet financial instruments:				
Commitments to grant loans	-	-	-	-
Unfunded commitments under lines of credit	-	-	-	-
Standby letters of credit	-	-	-	-

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

### **Note 18 – Parent Company Only Financial**

Condensed financial information pertaining only to the parent company, Embassy Bancorp, Inc., is as follows:

#### **BALANCE SHEETS**

	Years Ending December 31,	
	<u>2009</u>	<u>2008</u>
	(In Thousands)	
<b>ASSETS</b>		
Cash	\$ 467	\$ 100
Other assets	16	7
Investment in subsidiary	<u>38,849</u>	<u>31,679</u>
<b>Total Assets</b>	<b><u>\$ 39,332</u></b>	<b><u>\$ 31,786</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Long-term borrowings	\$ 5,650	\$ 1,400
Other liabilities	5	15
Stockholders' equity	<u>33,677</u>	<u>30,371</u>
<b>Total Liabilities and Stockholders' Equity</b>	<b><u>\$ 39,332</u></b>	<b><u>\$ 31,786</u></b>

#### **STATEMENT OF INCOME**

	Years Ending December 31,	
	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Interest income on interest bearing deposits	\$ 4	\$ -
Interest expense on borrowings	(282)	(1)
Other expenses	(99)	(6)
Undistributed net income of banking subsidiary	<u>2,989</u>	<u>1,191</u>
Income before income taxes	<u>2,612</u>	<u>1,844</u>
Income tax income (expense)	<u>121</u>	<u>(658)</u>
<b>Net income</b>	<b><u>\$ 2,733</u></b>	<b><u>\$ 1,186</u></b>

# ***Embassy Bancorp, Inc.***

## **Notes to Consolidated Financial Statements**

### **Note 18 – Parent Company Only Financial (Continued)**

#### **STATEMENT OF CASH FLOWS**

	Years Ending December 31,	
	<u>2009</u>	<u>2008</u>
	<b>(In Thousands)</b>	
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 2,733	\$ 1,186
Adjustments to reconcile net income to net cash provided by operating activities:		
Net change in other assets and liabilities	(19)	8
Equity in undistributed net income of banking subsidiary	<u>(2,989)</u>	<u>(1,191)</u>
<b>Net Cash (Used in) Provided by Operating Activities</b>	<u><b>(275)</b></u>	<u><b>3</b></u>
<b>Cash Flows from Investing Activities:</b>		
Capital contribution to banking subsidiary	<u>(3,771)</u>	<u>(1,317)</u>
<b>Net Cash Used in Investing Activities</b>	<u><b>(3,771)</b></u>	<u><b>(1,317)</b></u>
<b>Cash Flows from Financing Activities:</b>		
Proceeds from long-term borrowings	4,250	1,400
Proceeds from exercise of stock options	163	17
Purchase of treasury stock	<u>-</u>	<u>(3)</u>
<b>Net Cash Provided by Financing Activities</b>	<u><b>4,413</b></u>	<u><b>1,414</b></u>
<b>Net Increase in Cash</b>	<b>367</b>	<b>100</b>
<b>Cash – Beginning</b>	<u><b>100</b></u>	<u><b>-</b></u>
<b>Cash - Ending</b>	<u><u><b>\$ 467</b></u></u>	<u><u><b>\$ 100</b></u></u>

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF EMBASSY BANCORP, INC.**

This discussion and analysis provides an overview of the consolidated financial condition and results of operations of the Company for the years ended December 31, 2009 and 2008. This discussion should be read in conjunction with the consolidated financial statements and notes to consolidated financial statements appearing elsewhere in this report.

### **Forward-looking Statements**

This discussion contains forward-looking statements within the meaning of the Securities Exchange Act of 1934, as amended, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Bank operations and policies and regarding general economic conditions. These statements are based upon current and anticipated economic conditions, nationally and in the Company's market, interest rates and interest rate policy, competitive factors and other conditions that, by their nature, are not susceptible to accurate forecast, and are subject to significant uncertainty.

Such forward-looking statements can be identified by the use of forward-looking terminology such as "believes", "expects", "may", "intends", "will", "should", "anticipates", or the negative of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy.

No assurance can be given that the future results covered by forward-looking statements will be achieved. Such statements are subject to risks, uncertainties, and other factors that could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. Important factors that could impact the Company's operating results include, but are not limited to, (i) the effects of changing economic conditions in the Company's market areas and nationally, (ii) credit risks of commercial, real estate, consumer and other lending activities, (iii) significant changes in interest rates, (iv) changes in federal and state banking laws and regulations which could impact the Company's operations, and (iv) other external developments which could materially affect the Company's business and operations.

### **Critical Accounting Policies**

Note 1 to the Company's financial statements lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of the Company and its results of operations.

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, which require the Company to make estimates and assumptions. The Company believes that its determination of the allowance for loan losses and the valuation of deferred tax assets involve a higher degree of judgment and complexity than the Company's other significant accounting policies. Further, these estimates can be materially impacted by changes in market conditions or the actual or perceived financial condition of the Company's borrowers, subjecting the Company to significant volatility of earnings.

The allowance for loan losses is established through the provision for loan losses, which is a charge against earnings. Provision for loan losses is made to reserve for estimated probable losses on loans. The allowance for loan losses is a significant estimate and is regularly evaluated by the Company for adequacy by taking into consideration factors such as changes in the nature and volume of the loan portfolio, trends in actual and forecasted credit quality, including delinquency, charge-off and bankruptcy rates, and current economic conditions that may affect a borrower's ability to pay. The use of different estimates of assumptions could produce different provision for loan losses. For additional

## ***Embassy Bancorp, Inc.***

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discussion concerning the Company's allowance for loan losses and related matters, see "Provision for Loan Losses" and "Allowance for Loan Losses."

Deferred taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and net operating loss carryforwards and their tax basis. Deferred tax assets are reduced by a valuations allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Based upon the level of historical taxable income and projections for future taxable income over periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

### **GENERAL**

Embassy Bancorp, Inc. (the "Company") is a Pennsylvania corporation organized in 2008 and registered as a bank holding company pursuant to section 3(a)(1) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") and section 225.15 of Regulation Y. The Company was formed for purposes of acquiring Embassy Bank For The Lehigh Valley in connection with the reorganization of the Bank into a bank holding company structure, which reorganization was consummated on November 11, 2008. Accordingly, the Company owns all of the capital stock of the Bank, giving the organization more flexibility in meeting its capital needs as the Company continues to grow. As such, the consolidated financial statements contained herein include the accounts of the Company and the Bank.

The Bank was originally incorporated as a Pennsylvania bank on May 11, 2001 and opened its doors on November 6, 2001. It was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank's primary market area.

### **OVERVIEW**

The Company's assets grew \$74.1 million from \$391.1 million at December 31, 2008 to \$465.2 million at December 31, 2009. The Company's deposits grew \$73.7 million from \$307.6 million at December 31, 2008 to \$381.3 million at December 31, 2009. During the same period, loans receivable, net of the allowance for loan losses, increased \$29.7 million to \$346.3 million at December 31, 2009 from \$316.6 million at December 31, 2008. The market is very competitive and the Company is committed to maintaining a high quality portfolio that returns a reasonable market rate. The Company expects increased lending activity, as the Company expands its presence in the market and becomes more widely known. The lending staff has been active in contacting new prospects and promoting the Company's name in the community. Management believes that this will translate into continued growth of a portfolio of quality loans, although there can be no assurance of this.

The Company reported net income of \$2.7 million for the year ended December 31, 2009 as compared to net income of \$1.2 million for the year ended December 31, 2008.

### **RESULTS OF OPERATIONS**

#### **Net Interest Income and Net Interest Margin**

Net interest income is the difference between income on assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans and investments; interest-bearing deposits and borrowings make up the cost of funds. Non-interest bearing deposits and capital are other components representing funding sources. Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income.

## ***Embassy Bancorp, Inc.***

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### **2009 Compared to 2008**

Total interest income for the year ended December 31, 2009 was \$22.8 million compared to \$20.7 for the year ended December 31, 2008. Total interest expense for the year ended December 31, 2009 was \$9.2 million compared to \$11.1 million for the year ended December 31, 2008. The increase in interest income is due to growth in loan balances as well as investment securities. The decrease in interest expense is due to the lower interest rate environment as well as a shift in deposits from certificates of deposit to savings accounts. Net interest income increased to \$13.5 million for the year ended December 31, 2009 compared to \$9.6 million for the year ended December 31, 2008.

Generally, changes in net interest income are measured by net interest rate spread and net interest margin. Interest spread is the mathematical difference between the average interest earned on earning assets and interest paid on interest bearing liabilities. Interest margin represents the net interest yield on earning assets and is derived by dividing net interest income by average earning assets. In a mature financial institution the interest margin gives a reader better indicators of asset earning results when compared to peer groups or industry standards.

The Company's net interest margin for the year ended December 31, 2009 was 3.11% compared to 2.73% for the year ended December 31, 2008. The increase in the margin is due primarily to the increase in loan balances as well as current market conditions which have significantly reduced deposit account rates and had a lesser impact on loan rates. During this difficult market environment, the Company continued to grow and attract deposits and loans at competitive rates.

The following table includes the average balances, interest income and expense and the average rates earned and paid for assets and liabilities for the periods presented. All average balances are daily average balances.

# Embassy Bancorp, Inc.

## Average Balances, Rates and Interest Income and Expense

	Year Ended December 31, 2009			Year Ended December 31, 2008			Year Ended December 31, 2007		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest	Yield
<i>(dollars in thousands)</i>									
<b>ASSETS</b>									
Total loans	\$ 338,822	\$ 19,444	5.74%	\$ 300,162	\$ 18,272	6.09%	\$ 253,573	\$ 16,350	6.45%
Investment securities - taxable	59,044	2,590	4.39%	48,763	2,346	4.81%	47,514	2,305	4.85%
Investment securities - non-taxable (1)	11,303	452	6.03%	-	-	0.00%	-	-	0.00%
Federal funds sold	11,606	30	0.26%	1,807	29	1.60%	2,905	149	5.13%
Time deposits	10,002	232	2.32%	311	12	3.86%	-	-	0.00%
Interest bearing deposits with banks	4,713	7	0.15%	502	5	1.00%	105	5	4.76%
<b>TOTAL INTEREST EARNING ASSETS</b>	<b>435,490</b>	<b>22,755</b>	<b>5.23%</b>	<b>351,545</b>	<b>20,664</b>	<b>5.88%</b>	<b>304,097</b>	<b>18,809</b>	<b>6.19%</b>
Less allowance for loan losses	(3,251)			(2,706)			(2,489)		
Other assets	12,871			8,921			7,719		
<b>TOTAL ASSETS</b>	<b>\$ 445,110</b>			<b>\$ 357,760</b>			<b>\$ 309,327</b>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>									
Interest bearing demand deposits,									
NOW and money market	\$ 34,229	\$ 349	1.02%	\$ 36,299	\$ 712	1.96%	\$ 55,596	\$ 1,707	3.07%
Savings	159,544	2,721	1.71%	73,833	2,229	3.02%	18,146	639	3.52%
Certificates of deposit	144,695	4,549	3.14%	152,557	6,374	4.18%	161,550	8,029	4.97%
Securities sold under agreements to repurchase and other borrowings	50,674	1,609	3.18%	47,807	1,745	3.65%	30,454	1,388	4.56%
<b>TOTAL INTEREST BEARING LIABILITIES</b>	<b>389,142</b>	<b>9,228</b>	<b>2.37%</b>	<b>310,496</b>	<b>11,060</b>	<b>3.56%</b>	<b>265,746</b>	<b>11,763</b>	<b>4.43%</b>
Non-interest bearing demand deposits	19,284			15,102			14,465		
Other liabilities	3,555			3,720			3,653		
Stockholders' equity	33,129			28,442			25,463		
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 445,110</b>			<b>\$ 357,760</b>			<b>\$ 309,327</b>		
Net interest income		<u>\$ 13,527</u>			<u>\$ 9,604</u>			<u>\$ 7,046</u>	
Net interest spread			2.86%			2.32%			1.76%
Net interest margin			3.11%			2.73%			2.32%

(1) Yields on tax exempt assets have been calculated on a fully tax equivalent basis assuming a tax rate of 34%

## Embassy Bancorp, Inc.

The table below demonstrates the relative impact on net interest income of changes in the volume of interest-earning assets and interest-bearing liabilities and changes in rates earned and paid by the Company on such assets and liabilities.

	2009 vs. 2008			2008 vs. 2007		
	Increase (decrease) due to changes in:			Increase (decrease) due to changes in:		
	Volume	Rate	Total	Volume	Rate	Total
(Dollars In Thousands)						
Interest-earning assets:						
Total loans	\$ 2,353	\$ (1,181)	\$ 1,172	\$ 3,004	\$ (1,082)	\$ 1,922
Investment securities - taxable	495	(252)	243	61	(20)	41
Investment securities - non-taxable	452	-	452	-	-	-
Federal funds sold	157	(156)	1	(56)	(64)	(120)
Time Deposits	374	(154)	220	-	12	12
Interest bearing deposits with banks	42	(39)	3	19	(19)	-
Total net change in income on interest-earning assets	3,873	(1,782)	2,091	3,028	(1,173)	1,855
Interest-bearing liabilities:						
Interest bearing demand deposits and money markets	(41)	(322)	(363)	(592)	(403)	(995)
Savings	2,588	(2,096)	492	1,961	(371)	1,590
Certificates of deposit	(328)	(1,497)	(1,825)	(447)	(1,208)	(1,655)
Total deposits	2,219	(3,915)	(1,696)	922	(1,982)	(1,060)
Securities sold under agreements to repurchase and other borrowings	105	(241)	(136)	791	(434)	357
Total net change in expense on interest-bearing liabilities	2,324	(4,156)	(1,832)	1,713	(2,416)	(703)
Change in net interest income	\$ 1,549	\$ 2,374	\$ 3,923	\$ 1,315	\$ 1,243	\$ 2,558

### Provision for Loan Losses

The provision for loan losses represents the expense recognized to fund the allowance for loan losses. This amount is based on many factors that reflect management's assessment of the risk in its loan portfolio. Those factors include economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company.

For the year ended December 31, 2009, the provision for loan losses was \$702 thousand compared to \$429 thousand for the year ended December 31, 2008. The allowance for loan losses as of December 31, 2009 was \$3.6 million, which represents 1.03% of outstanding loans at December 31, 2009, which is comparable to the prior year-end of \$2.9 million representing 0.92% of outstanding loans. Based principally on current economic conditions, perceived asset quality, loan-loss experience of comparable institutions in the Company's market area, the allowance is believed to be adequate. The increase in the percentage of allowance for loan losses to outstanding loans between December 31, 2008 and December 31, 2009 was due to an increase in loan volume and impairment of certain loans.

### Non-interest Income

Non-interest income is derived from the Company's operations and represents primarily service charge income and fees on deposit relationships. Non-interest income also may include net gains and losses from the sale of available for sale securities. Total non-interest income was \$1.0 million for the year ended December 31, 2009 compared to \$661 thousand for the year ended December 31, 2008. This increase in non-interest income is due to increased service fees from the increase in the number of deposit accounts as well as an increase in merchant credit card processing services. Sales of securities in 2009 totaled \$3.1 million with net gains of \$174 thousand; the proceeds were used, in part, to pay down FHLB debt. There were no sales of securities in 2008. As the account base grows and the Company matures and develops additional sources of fee income, non-interest income will be a contributor to the overall profitability of the Company.

# ***Embassy Bancorp, Inc.***

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## **Non-interest Expense**

Non-interest expenses represent the normal operating expenses of the Company. These expenses include salaries, employee benefits, occupancy, equipment, data processing, advertising and other expenses related to the overall operation of the Company.

Non-interest expenses for the year ended December 31, 2009 were \$9.9 million, compared to \$8.0 million for the year ended December 31, 2008. The largest component increase was in FDIC insurance, which increased \$531 thousand or 334% due to increased deposit volume, higher premium rates, and a special assessment to replenish the FDI fund. At December 31, 2009, the Company had fifty-seven full-time equivalent employees compared to fifty-one full-time equivalent employees at December 31, 2008. Salaries and benefits increased \$503 thousand or 13% due primarily to staff additions, increases in annual salaries and employee insurance benefits. Occupancy and equipment expense increased \$339 thousand or 27% due to the additional expense for two new branches, additions, maintenance and repairs of computer equipment, and software expenses. Data processing costs increased \$69 thousand or 11% due to increased volume of accounts and enhanced network support services. Advertising and marketing expense increased \$11 thousand or 2% due to product promotions and our image campaign within the community. Professional fees increased \$57 thousand or 18% due to increased costs and expansion of primarily third party auditing, regulatory and consulting services. Credit card expense increased \$154 thousand or 42% due to increased volume. Loan expense increased \$52 thousand or 65%, due to increased collection activities. Other expenses increased \$207 thousand or 37% due to the Company's growth.

A breakdown of other non-interest expenses is included in the consolidated statements of income in the Consolidated Financial Statements.

## **Income Taxes**

The provision for income taxes was \$1.2 million at December 31, 2009 compared to \$658 thousand at December 31, 2008.

## **FINANCIAL CONDITION**

### **Securities**

The Company's securities portfolio is classified, in its entirety, as "available for sale." Management believes that a portfolio classification of available for sale allows complete flexibility in the investment portfolio. Using this classification, the Company intends to hold these securities for an indefinite amount of time but not necessarily to maturity. Such securities are carried at fair value with unrealized gains or losses reported as a separate component of stockholders' equity. The portfolio is structured to provide maximum return on investments while providing a consistent source of liquidity and meeting strict risk standards. The Company holds no high-risk securities or derivatives as of December 31, 2009.

The Company's securities portfolio was \$72.8 million at December 31, 2009, an \$18.5 million increase from securities of \$54.3 million at December 31, 2008. The Company's securities have increased due to purchases in the amount of \$32.6 million offset by investment principal pay-downs, maturities and sales. The carrying value of the securities portfolio as of December 31, 2009 includes a net unrealized gain of \$2.1 million as compared to a net unrealized gain of \$1.5 million as of December 31, 2008, which is recorded to accumulated other comprehensive income in stockholders' equity. This increase in the unrealized gain is due to the changes in market interest rates from 2008 to 2009, and therefore no securities are deemed to be other than temporarily impaired.

## ***Embassy Bancorp, Inc.***

The following table sets forth the composition of the securities portfolio at fair value as of December 31, 2009, 2008, 2007, 2006, and 2005.

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(Dollars In Thousands)				
U.S. Treasury and agency obligations	\$ 17,083	\$ 11,697	\$ 11,146	\$ 10,767	\$ 10,766
Mortgage-backed securities - residential	23,119	37,108	34,494	28,510	27,760
Municipal securities	28,574	5,446	3,856	3,820	3,781
Corporate bonds	4,019	-	-	-	-
Total Securities Available for Sale	<u>\$ 72,795</u>	<u>\$ 54,251</u>	<u>\$ 49,496</u>	<u>\$ 43,097</u>	<u>\$ 42,307</u>

The following table presents the maturities and average weighted yields of the debt securities portfolio as of December 31, 2009. Maturities of mortgage-backed securities are based on estimated life. Yields are based on amortized cost.

### **Securities by Maturities (Amortized Cost)**

	<u>1 year or Less</u>		<u>1-5 Years</u>		<u>5-10 Years</u>		<u>Over 10 Years</u>		<u>Total</u>	
	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>
	(Dollars In Thousands)									
U.S. Government agency obligations	\$ 7,992	4.37%	\$ 6,015	2.79%	\$ 993	4.70%	\$ 1,583	3.40%	\$ 16,583	3.72%
Municipal securities	\$ 1,001	4.73%	\$ 4,690	4.53%	\$ 3,574	5.22%	\$ 18,892	6.06%	\$ 28,157	5.65%
Corporate bonds	\$ -	-	\$ 3,787	5.59%	\$ -	-	\$ -	-	\$ 3,787	5.59%
Mortgage-backed securities - residential	<u>\$ 279</u>	4.05%	<u>\$ 21,392</u>	4.86%	<u>\$ 499</u>	4.89%	<u>\$ -</u>	0.00%	<u>\$ 22,170</u>	4.85%
Total Debt Securities	<u>\$ 9,272</u>	4.40%	<u>\$ 35,884</u>	4.54%	<u>\$ 5,066</u>	5.08%	<u>\$ 20,475</u>	5.85%	<u>\$ 70,697</u>	4.94%

# Embassy Bancorp, Inc.

## Loans

The following table sets forth information on the composition of the loan portfolio by type at December 31, 2009, 2008, 2007, 2006, and 2005. All of the Company's loans are to domestic borrowers.

	<u>December 31, 2009</u>		<u>December 31, 2008</u>		<u>December 31, 2007</u>	
	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>
	(Dollars In Thousands)					
Commercial real estate	\$ 150,439	43.00%	\$ 148,881	46.62%	\$ 125,021	45.21%
Commercial construction	12,292	3.51%	6,886	2.16%	2,969	1.07%
Commercial	25,796	7.37%	24,096	7.55%	22,583	8.17%
Home equity	159,180	45.50%	136,739	42.82%	123,774	44.75%
Consumer	<u>2,160</u>	0.62%	<u>2,726</u>	0.85%	<u>2,216</u>	0.80%
Gross loans	349,867	100.00%	319,328	100.00%	276,563	100.00%
Unearned origination costs	<u>51</u>		<u>252</u>		<u>253</u>	
	<u>\$ 349,918</u>		<u>\$ 319,580</u>		<u>\$ 276,816</u>	
	<u>December 31, 2006</u>		<u>December 31, 2005</u>			
	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>		
	(Dollars In Thousands)					
Commercial real estate	\$ 101,737	43.21%	\$ 77,854	43.46%		
Commercial construction	6,183	2.63%	2,626	1.47%		
Commercial	21,578	9.17%	16,906	9.44%		
Home equity	103,895	44.14%	80,726	45.07%		
Consumer	<u>2,006</u>	0.85%	<u>1,003</u>	0.56%		
Gross loans	235,399	100.00%	179,115	100.00%		
Unearned origination costs	<u>194</u>		<u>207</u>			
	<u>\$ 235,593</u>		<u>\$ 179,322</u>			

The following table shows the maturities of the commercial loan portfolio and the sensitivity of such loans to interest rate fluctuations at December 31, 2009.

	<u>One year or Less</u>	<u>After One Year Through Five Years</u>	<u>After Five Years</u>	<u>Total</u>
	(Dollars In Thousands)			
Commercial real estate	\$ 35,340	\$ 81,032	\$ 34,067	\$ 150,439
Commercial construction	9,667	2,625	-	12,292
Commercial	<u>12,511</u>	<u>12,548</u>	<u>737</u>	<u>25,796</u>
	<u>\$ 57,518</u>	<u>\$ 96,205</u>	<u>\$ 34,804</u>	<u>\$ 188,527</u>
Fixed Rates	\$ 16,448	\$ 91,126	\$ 34,723	\$ 142,297
Variable Rates	<u>41,070</u>	<u>5,079</u>	<u>81</u>	<u>46,230</u>
	<u>\$ 57,518</u>	<u>\$ 96,205</u>	<u>\$ 34,804</u>	<u>\$ 188,527</u>

### **Credit Risk and Loan Quality**

In its lending activities, the Company seeks to develop sound credit relationships with customers who will grow with the Company. There has not been an effort to rapidly build the portfolio and earnings at the sacrifice of asset quality. The philosophy of seeking quality credits and building relationships while possibly forgoing income opportunities will continue.

The Company's loan policy establishes tiered lending authorities to individual officers of the Company, the Loan Committee and the Board of Directors. At December 31, 2009, the Company had one loan delinquent beyond ninety days and still accruing interest for \$584 thousand, as compared to two loans (to a single borrower) delinquent beyond ninety days and still accruing interest for \$818 thousand at December 31, 2008, no loans delinquent beyond ninety days and still accruing interest at December 31, 2007, three loans delinquent (two to a single borrower) for \$206 thousand at December 31, 2006, and one loan delinquent for \$102 thousand at December 31, 2005. At December 31, 2009, the Company had five loans in non-accrual status totaling \$4.2 million, as compared to no loans on non-accrual status at December 31, 2008 and 2007, two loans on non-accrual status for \$205 thousand at December 31, 2006 and no loans on non-accrual status at year ending 2005. At December 31, 2009 the Company had two loans charged off for the year totaling \$21 thousand, and interest charged off in the amount of \$15 thousand, as compared to no loans charged off for the year ended 2008, two loans totaling \$313 thousand charged off for the year ending 2007, and no loans charged off at years ending 2006, and 2005. It is the Company's policy to discontinue the accrual of interest when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. The Company has had no other real estate owned as acquired through foreclosure.

### **Allowance for Loan Losses**

Based upon current economic conditions, the composition of the loan portfolio and loan loss experience of comparable institutions in the Company's market areas, an allowance for loan losses has been provided at 1.03% of outstanding loans. Based on its knowledge of the portfolio and current economic conditions, management believes that as of December 31, 2009, the allowance is adequate to absorb reasonably anticipated losses. As of December 31, 2009, the Company had impaired loans of \$595 thousand requiring a specific reserve of \$267 thousand. As of December 31, 2009, the Company had impaired loans of \$4.2 million not requiring any specific reserve.

## Embassy Bancorp, Inc.

The activity in the allowance for loan losses is shown in the following table as well as period end loans receivable and the allowance for loan losses as a percent of the total loan portfolio:

	<b>December 31,</b>				
	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(Dollars In Thousands)				
Loans receivable at end of year	<u>\$ 349,918</u>	<u>\$ 319,580</u>	<u>\$ 276,816</u>	<u>\$ 235,593</u>	<u>\$ 179,322</u>
Allowance for loan losses:					
Balance, beginning	\$ 2,932	\$ 2,503	\$ 2,426	\$ 1,782	\$ 1,198
Provision for loan losses	702	429	390	644	584
Commercial loans charged off	(36)	-	(313)	-	-
Recoveries	-	-	-	-	-
Balance at end of year	<u>\$ 3,598</u>	<u>\$ 2,932</u>	<u>\$ 2,503</u>	<u>\$ 2,426</u>	<u>\$ 1,782</u>
Allowance for loan losses to loans receivable at end of year	<u>1.03%</u>	<u>0.92%</u>	<u>0.90%</u>	<u>1.03%</u>	<u>0.99%</u>

The following table details the allocation of the allowance for loan losses to various loan categories. While allocations have been established for particular loan categories, management considers the entire allowance to be available to absorb losses in any category.

### Allocation of the Allowance for Loan Losses

	<u>December</u>	<u>% of Gross</u>	<u>December</u>	<u>% of Gross</u>	<u>December</u>	<u>% of Gross</u>	<u>December</u>	<u>% of Gross</u>	<u>December</u>	<u>% of Gross</u>
	<u>2009</u>	<u>Loans</u>	<u>2008</u>	<u>Loans</u>	<u>2007</u>	<u>Loans</u>	<u>2006</u>	<u>Loans</u>	<u>2005</u>	<u>Loans</u>
	(Dollars In Thousands)									
Commercial real estate	\$ 1,654	38.41%	\$ 1,563	41.53%	\$ 1,257	40.29%	\$ 1,041	38.35%	\$ 713	43.46%
Commercial construction	207	3.51%	101	2.15%	47	1.07%	91	2.59%	60	1.47%
Commercial	679	11.96%	639	12.60%	623	13.03%	806	14.04%	611	9.44%
Home equity	1,005	45.21%	595	42.79%	530	44.33%	461	44.15%	382	45.07%
Consumer	53	0.91%	34	0.93%	46	1.28%	27	0.85%	16	0.56%
Total Allowance for Loan Losses	<u>\$ 3,598</u>	100.00%	<u>\$ 2,932</u>	100.00%	<u>\$ 2,503</u>	100.00%	<u>\$ 2,426</u>	100.00%	<u>\$ 1,782</u>	100.00%

### Deposits

The Company, as growth continues, expects that the principal sources of its funds will be deposits, consisting of demand deposits, NOW accounts, money market accounts, savings accounts, and certificates of deposit from the local market areas surrounding the Company's office. These accounts provide the Company with a source of fee income and a relatively stable source of funds.

Total deposits at December 31, 2009 were \$381.3 million, an increase of \$73.7 million, or 23.96%, over total deposits of \$307.6 million as of December 31, 2008.

## ***Embassy Bancorp, Inc.***

The following table reflects the Company's deposits by category for the periods indicated. All deposits are domestic deposits.

	<u>December 31, 2009</u>	<u>December 31, 2008</u>	<u>December 31, 2007</u>
		(Dollars In Thousands)	
Demand, non-interest bearing	\$ 25,785	\$ 16,194	\$ 15,150
Demand and money market, interest bearing	32,987	31,437	46,095
Savings	201,727	103,863	37,489
Time, \$100 and over	54,821	65,344	59,421
Time, other	<u>65,964</u>	<u>90,732</u>	<u>108,486</u>
Total deposits	<u>\$ 381,284</u>	<u>\$ 307,570</u>	<u>\$ 266,641</u>

The following table sets forth the average balance of the Company's deposits and the average rates paid on those deposits for the years ended December 31, 2009, 2008, and 2007.

	Years Ended December 31,					
	<u>2009</u>		<u>2008</u>		<u>2007</u>	
	<u>Average Amount</u>	<u>Average Rate</u>	<u>Average Amount</u>	<u>Average Rate</u>	<u>Average Amount</u>	<u>Average Rate</u>
			(Dollars In Thousands)			
Demand and money market, interest bearing	\$ 34,229	1.02%	\$ 36,299	1.96%	\$ 55,596	3.07%
Savings	159,544	1.71%	73,833	3.02%	18,146	3.52%
Certificates of deposit	<u>144,695</u>	<u>3.14%</u>	<u>152,557</u>	<u>4.18%</u>	<u>161,550</u>	<u>4.97%</u>
Total interest bearing deposits	338,468	2.25%	262,689	3.55%	235,292	4.41%
Non-interest bearing demand deposits	<u>19,284</u>		<u>15,102</u>		<u>14,465</u>	
Total	<u>\$ 357,752</u>		<u>\$ 277,791</u>		<u>\$ 249,757</u>	

The following table displays the maturities and the amounts of the Company's certificates of deposit of \$100,000 or more as of December 31, 2009.

	<u>December 31, 2009</u>
	(Dollars In Thousands)
3 months or less	\$ 25,607
Over 3 through 6 months	7,640
Over 6 through 12 months	11,787
Over 12 months	<u>9,787</u>
Total	<u>\$ 54,821</u>

As a FDIC member institution, the Company's deposits are insured to a maximum of \$250,000 per depositor through the Bank Insurance Fund ("BIF") that is administered by the FDIC and each institution is required to pay semi-annual deposit insurance premium assessments to the FDIC.

### **Liquidity**

Liquidity is a measure of the Company's ability to meet the demands required for the funding of loans and to meet depositors' requirements for use of their funds. The Company's sources of liquidity are cash balances, due from banks, Federal funds sold and short-term securities. There are other sources of liquidity that are available to the Company.

## ***Embassy Bancorp, Inc.***

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The Bank has borrowing capacity with the FHLB of Pittsburgh of approximately \$183.4 million, of which \$11.4 million was outstanding at December 31, 2009, all of which is long term. The Bank also has a line of credit with the FHLB of Pittsburgh and the Atlantic Central Bankers Bank of approximately \$25.0 million and \$6.0 million, respectively, of which none was outstanding at December 31, 2009. Advances from the Federal Home Loan Bank line are secured by qualifying assets of the Bank and advances from the Atlantic Central Bankers Bank line are unsecured. The Company has two lines of credit with Univest National Bank and Trust Company, totaling \$10.0 million, of which \$5.6 million was outstanding at December 31, 2009. These lines of credit are secured by 833,333 shares of Bank stock.

Because of the composition of the Company's balance sheet, its strong capital base, deposit growth, and borrowing capacity, the Company remains well positioned with respect to liquidity. While it is desirable to be liquid, it has the effect of a lower interest margin. The majority of funds are invested in loans; however, a sizeable portion is invested in investment securities that generally carry a lower yield.

### **Contractual Obligations**

The following table represents the Company's contractual obligations to make future payments as of December 31, 2009:

	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>Over 5 Years</b>	<b>Total</b>
			(In Thousands)		
Time deposits	\$ 89,686	\$ 27,821	\$ 3,278	\$ -	\$ 120,785
Long-term borrowings	2,000	1,480	7,886	5,650	17,016
Operating Leases	884	1,934	1,534	3,875	8,227
Total	<u>\$ 92,570</u>	<u>\$ 31,235</u>	<u>\$ 12,698</u>	<u>\$ 9,525</u>	<u>\$ 146,028</u>

### **Off-Balance Sheet Arrangements**

The Company's financial statements do not reflect various off-balance sheet arrangements that are made in the normal course of business, which may involve some liquidity risk. These commitments consist of unfunded loans and lines of credit and letters of credit made under the same standards as on-balance sheet instruments. These off-balance sheet arrangements at December 31, 2009 totaled \$65.4 million. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Company.

Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

The Company has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources.

### **Capital Resources and Adequacy**

The Company is a Pennsylvania corporation organized in 2008 and registered as a bank holding company pursuant to section 3(a)(1) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") and section 225.15 of Regulation Y. The Company was formed for purposes of acquiring Embassy Bank For The Lehigh Valley in connection with the reorganization of the Bank into a bank holding company structure, which reorganization was consummated on November 11, 2008. Accordingly, the Company owns all of the capital stock of the Bank, giving the

## ***Embassy Bancorp, Inc.***

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organization more flexibility in meeting its capital needs as the Company continues to grow. As such, the consolidated financial statements contained herein include the accounts of the Company and the Bank.

The Bank was originally incorporated as a Pennsylvania bank on May 11, 2001 and opened its doors on November 6, 2001. It was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank's primary market area.

The Federal Reserve Board approved a final rule in February 2006 that expands the definition of a small bank holding company ("BHC") under the Board's Small Bank Holding Company Policy Statement and the Board's risk-based and leverage capital guidelines for bank holding companies. In its revisions to the Policy Statement, the Federal Reserve Board has raised the small BHC asset size threshold from \$150 million to \$500 million and amended the related qualitative criteria for determining eligibility as a small BHC for the purposes of the policy statement and the capital guidelines. The policy statement facilitates the transfer of ownership of small community banks by permitting debt levels at small BHCs that are higher than what would typically be permitted for larger BHCs. Because small BHCs may, consistent with the policy statement, operate at a level of leverage that generally is inconsistent with the capital guidelines, the capital guidelines provide an exemption for small BHCs. Based on the ruling, Embassy Bancorp, Inc. meets the eligibility criteria of a small BHC and is exempt from regulatory capital requirements administered by the federal banking agencies.

The following table provides a comparison of the Bank's risk-based capital ratios and leverage ratios:

	<u>December 31, 2009</u>	<u>December 31, 2008</u>
	(Dollars In Thousands)	
Tier I, common stockholders' equity	\$ 37,464	\$ 30,705
Tier II, allowable portion of allowance for loan losses	<u>3,598</u>	<u>2,932</u>
Total capital	<u>\$ 41,062</u>	<u>\$ 33,637</u>
Tier I risk based capital ratio	11.7%	10.7%
Total risk based capital ratio	12.8%	11.7%
Tier I leverage ratio	8.1%	8.1%

Note: Unrealized gains on securities available for sale are excluded from regulatory capital components of risk-based capital and leverage ratios.

At December 31, 2009, the Bank exceeded the minimum regulatory capital requirements necessary to be considered a "well capitalized" financial institution under applicable federal regulations.

### **Interest Rate Risk Management**

A principal objective of the Company's asset/liability management policy is to minimize the Company's exposure to changes in interest rates by an ongoing review of the maturity and repricing of interest-earning assets and interest-bearing liabilities. The Asset Liability Committee (ALCO Committee), which meets as part of the Board of Directors meeting, oversees this review, which establishes policies to control interest rate sensitivity. Interest rate sensitivity is the volatility of a company's earnings resulting from a movement in market interest rates. The Company monitors rate sensitivity in order to reduce vulnerability to interest rate fluctuations while maintaining adequate capital levels and acceptable levels of liquidity. The Company's asset/liability management policy, along with monthly financial reports, supplies management with guidelines to evaluate and manage rate sensitivity.

## ***Embassy Bancorp, Inc.***

GAP, a measure of the difference in volume between interest bearing assets and interest bearing liabilities, is a means of monitoring the sensitivity of a financial institution to changes in interest rates. The chart below provides an indicator of the rate sensitivity of the Company. NOW and Savings accounts are slotted by their respective estimated decay rates. The Company is liability sensitive, which means that if interest rates fall, interest income will fall slower than interest expense and net interest income will likely increase. If interest rates rise, interest income will rise slower than interest expense and net interest income will likely decrease.

	<b>0-3</b>	<b>4-12</b>	<b>1-3</b>	<b>4-5</b>	<b>Over 5</b>	<b>Total</b>
	<b>Months</b>	<b>Months</b>	<b>Years</b>	<b>Years</b>	<b>Years</b>	
(In Thousands)						
<b>Interest-earning assets</b>						
Federal funds sold and interest-bearing deposits	\$ 33,080	\$ -	\$ -	\$ -	\$ -	\$ 33,080
Investment securities	4,184	15,974	17,382	8,289	29,075	74,904
Loans, gross	69,902	59,994	100,709	61,357	57,956	349,918
<b>Total interest-earning assets</b>	<b>107,166</b>	<b>75,968</b>	<b>118,091</b>	<b>69,646</b>	<b>87,031</b>	<b>457,902</b>
<b>Interest-bearing liabilities</b>						
NOW and money market accounts	32,987	-	-	-	-	32,987
Savings	201,727	-	-	-	-	201,727
Certificates of deposit	39,686	50,000	27,821	3,278	-	120,785
Other Borrowed Funds	2,000	-	1,480	13,536	-	17,016
Repurchase agreements and federal funds purchased	30,964	-	-	-	-	30,964
<b>Total interest-bearing liabilities</b>	<b>307,364</b>	<b>50,000</b>	<b>29,301</b>	<b>16,814</b>	<b>-</b>	<b>403,479</b>
<b>GAP</b>	<b>\$ (200,198)</b>	<b>\$ 25,968</b>	<b>\$ 88,790</b>	<b>\$ 52,832</b>	<b>\$ 87,031</b>	<b>\$ 54,423</b>
<b>CUMULATIVE GAP</b>	<b>\$ (200,198)</b>	<b>\$ (174,230)</b>	<b>\$ (85,440)</b>	<b>\$ (32,608)</b>	<b>\$ 54,423</b>	
<b>GAP TO INTEREST EARNING ASSETS</b>	<b>-43.72%</b>	<b>5.67%</b>	<b>19.39%</b>	<b>11.54%</b>	<b>19.01%</b>	
<b>CUMULATIVE GAP TO INTEREST EARNING ASSETS</b>	<b>-43.72%</b>	<b>-38.05%</b>	<b>-18.66%</b>	<b>-7.12%</b>	<b>11.89%</b>	

Based on a twelve-month forecast of the balance sheet, the following table sets forth our interest rate risk profile at December 31, 2009. For income simulation purposes, NOW and savings accounts are repriced quarterly. The impact on net interest income, illustrated in the following table would vary substantially if different assumptions were used or if actual experience differs from that indicated by the assumptions.

<b><u>Change in Interest Rates</u></b>	<b><u>Percentage Change in Net Interest Income</u></b>
Down 100 basis points	-0.2%
Down 200 basis points	-4.8%
Up 100 basis points	-6.5%
Up 200 basis points	-12.8%

## ***Embassy Bancorp, Inc.***

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### **Return on Assets and Equity**

The return on average assets for 2009 was 0.61%; the return on average equity for the same period was 8.24%; and the ratio of average shareholders' equity to average total assets was 7.44%.

The return on average assets for 2008 was 0.33%; the return on average equity for the same period was 4.17%; and the ratio of average shareholders' equity to average total assets was 7.95%.

### **Effects of Inflation**

The majority of assets and liabilities of the Company are monetary in nature, and therefore, differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. The precise impact of inflation upon the Company is difficult to measure. Inflation may affect the borrowing needs of consumers, thereby impacting the growth rate of the Company's assets. Inflation may also affect the general level of interest rates, which can have a direct bearing on the Company.

### **Quantitative and qualitative disclosures about market risks.**

Not Applicable.



## ***Corporate Information***

### **Embassy Bancorp, Inc.**

Embassy Bancorp, Inc. (the “Company”) is a Pennsylvania corporation and registered as a bank holding company. It owns all of the capital stock of Embassy Bank For The Lehigh Valley (the “Bank”), giving the Bank more flexibility in meeting its capital needs as the Bank continues to grow.

Embassy Bank is a full service bank providing personal and business lending and deposit services.

### **Common Stock Outstanding**

On April 15, 2010, there were 6,940,310 shares of the Company’s common stock outstanding and 1,277 shareholders of record.

### **Transfer Agent**

Registrar and Transfer Company  
10 Commerce Drive  
Cranford, NJ 07016  
1-800-368-5948

### **Embassy Bancorp, Inc. and Embassy Bank For The Lehigh Valley**

100 Gateway Drive, Suite 100  
P.O. Box 20405  
Lehigh Valley, PA 18002-0405  
610-882-8800 Fax: 610-691-5600  
www.embassybank.com

### **Annual Meeting**

The Annual Meeting of Embassy Bancorp, Inc. is scheduled for 5:30 PM, June 16, 2010 at the Best Western Lehigh Valley Hotel and Conference Center, 300 Gateway Drive, Bethlehem, PA. All shareholders are invited to join us for a reception immediately following the meeting.

### **Form 10-K Request**

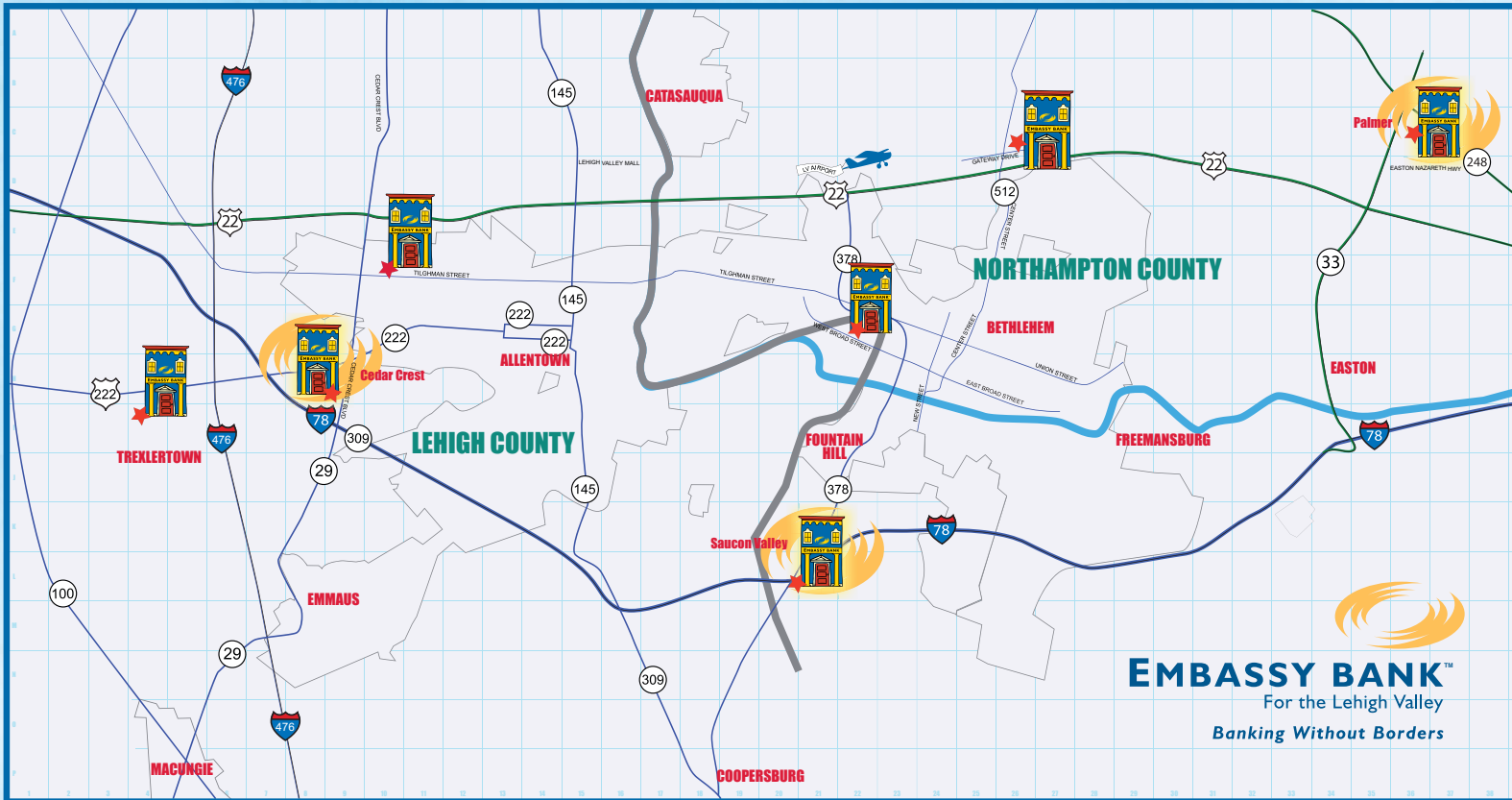
The Company’s Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, is available without charge on-line at the SEC’s website at <http://www.sec.gov> or by contacting:

Judith Hunsicker, Chief Operating Officer  
Embassy Bancorp, Inc.  
P.O. Box 20405  
Lehigh Valley, PA 18002-0405

### **Market Price of Common Stock & Dividend Information**

The Company’s common stock is not traded on any exchange and there is no established public trading market for the Company’s common stock. No broker makes a market in the Company’s common stock.

The Company has not declared or paid any cash dividends on its common stock. As a general matter, cash available for dividend distribution to shareholders of the Company must initially come from dividends paid to the Company by the Bank. As a result, legal restrictions on the payment of dividends by the Bank affect the ability of the Company to pay dividends. The Pennsylvania Banking Code of 1965, as amended, provides that cash dividends may be paid from accumulated net earnings (retained earnings) as long as minimum capital requirements are met. The Directors of the Bank intend to continue the policy of retaining earnings in order to support anticipated growth.



ALLENTOWN | 4148 W. Tilghman Street | 6379 Hamilton Boulevard | 1142 S Cedar Crest Boulevard

BETHLEHEM | 100 Gateway Drive | 925 West Broad Street | 3495 Route 378

EASTON | 3751 Easton Nazareth Hwy



[www.embassybank.com](http://www.embassybank.com)

