

Edgar Filing: WATER CHEF INC - Form 424B3

WATER CHEF INC
Form 424B3
April 25, 2006

Rule 424(b)(3)
Registration Statement 333-122252

PROSPECTUS SUPPLEMENT

DATED APRIL 25, 2006

TO

PROSPECTUS DATED MAY 25, 2005

WATER CHEF, INC.

This Prospectus Supplement, dated April 25, 2006 (the "Supplement No. 1"), supplements that certain Prospectus dated May 25, 2005 (the "Prospectus") and should be read in conjunction with the Prospectus.

On August 15, 2005, we filed with the Securities and Exchange Commission (the "SEC") the attached Quarterly Report on Form 10-QSB for the period ended June 30, 2005 and on November 8, 2005 we filed with the SEC the attached Quarterly Report on Form 10-QSB for the period ended September 30, 2005. On March 22, 2006, we filed with the SEC the attached Annual Report on Form 10-KSB for the year ended December 31, 2005. The attached information supplements and supersedes, in part, the information contained in the Prospectus.

All provisions of the Prospectus not specifically amended by this Supplement remain in full force and effect.

Please insert this Supplement No. 1 into your Prospectus and retain both this Supplement and the Prospectus for future reference. If you would like to receive a copy of the Prospectus, as supplemented to date, please write to Water Chef, Inc. at 1007 Glen Cove Avenue, Suite 1, Glen Head, NY 11545 or call (516) 656-0059.

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

Form 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2005

TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE EXCHANGE ACT

For the transition period from to

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Commission file number 1-09478

WATER CHEF, INC.

(Exact name of small business issuer as specified in its charter)

Delaware

86-0515678

(State of other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

1007 Glen Cove Avenue, Suite 1, Glen Head, New York 11545

(Address of principal executive offices)

516-656-0059

(Issuer's telephone number)

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

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

State the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date.

OUTSTANDING AS OF August 12, 2005

CLASS	Common
-----	-----
Par value \$0.001 per share	163,922,112

WATER CHEF, INC.

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At June 30, 2005	

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WATER CHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)
CONDENSED BALANCE SHEET
AT JUNE 30, 2005
(UNAUDITED)

ASSETS	

CURRENT ASSETS:	
Cash	\$ 992
Inventory	30,000
Prepaid expenses	10,294

TOTAL CURRENT ASSETS	41,286

OTHER ASSETS:	
Patents and trademarks - net of accumulated amortization of \$7,871	18,184
Other assets	3,162

TOTAL OTHER ASSETS	21,346

TOTAL ASSETS	\$ 62,632

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LIABILITIES AND STOCKHOLDERS' DEFICIENCY

CURRENT LIABILITIES:

Accounts payable (including related party payable of \$18,875)	\$ 232,869
Accrued expenses and other current liabilities	1,245,188
Notes payable (including accrued interest of \$512,635)	1,195,857
Accrued dividends payable	91,003
Customer deposits	115,000

TOTAL CURRENT LIABILITIES 2,879,917

LONG-TERM LIABILITIES:

Loans payable to stockholder (including accrued interest of \$117,155)	489,936
--	---------

TOTAL LIABILITIES 3,369,853

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' DEFICIENCY:

Preferred stock - \$.001 par value; 10,000,000 shares authorized; 524,423 shares issued and outstanding, (liquidation preference \$1,112,250)	525
Common stock - \$.001 par value; 190,000,000 shares authorized; 160,899,727 shares issued and 160,895,327 shares outstanding	160,896
Additional paid-in capital	20,386,429
Treasury stock, at cost - 4,400 shares of common stock	(5,768)
Deficit accumulated through December 31, 2001	(14,531,596)
Deficit accumulated during development stage	(9,317,707)

TOTAL STOCKHOLDERS' DEFICIENCY (3,307,221)

TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY \$ 62,632

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See notes to condensed financial statements.

WATER CHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)
CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the Three Months Ended June 30,	For the Si J
2005	2004	2005

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SALES	\$	--	\$	--	\$	260,000
COST OF SALES		21,000		24,000		21,000
GROSS (LOSS) PROFIT		<u>(21,000)</u>		<u>(24,000)</u>		<u>239,000</u>
SELLING, GENERAL AND ADMINISTRATIVE - including stock based compensation of \$0, and \$0 for the three months ended June 30, 2005 and 2004 and \$18,000 and \$182,387 for the six months ended June 30, 2005 and 2004, and \$741,563 for the period January 1, 2002 to June 30, 2005, respectively		297,227		270,974		645,206
NON-DILUTION AGREEMENT TERMINATION COST		--		(522,339)		--
INTEREST EXPENSE (Including interest expense to related party of \$5,970 and \$11,930 for the three and six months ended June 30, 2005 and 2004, respectively and \$83,538 for the period January 1, 2002 to June 30, 2005		37,557		37,557		75,114
LOSS ON SETTLEMENT OF DEBT		--		2,313,716		--
FINANCING COST - EXTENSION OF WARRANTS		74,700		94,151		74,700
STOCK APPRECIATION RIGHTS - REDUCTION IN VALUE		--		--		(121,340)
NET LOSS		<u>(430,484)</u>		<u>(2,218,059)</u>		<u>(434,680)</u>
DEEMED DIVIDEND ON PREFERRED STOCK		--		(2,072,296)		--
PREFERRED STOCK DIVIDENDS		(42,758)		(70,320)		(86,643)
NET LOSS APPLICABLE TO COMMON STOCKHOLDERS	\$	<u>(473,242)</u>	\$	<u>(4,360,675)</u>	\$	<u>(521,323)</u>
BASIC AND DILUTED LOSS PER COMMON SHARE	\$	<u>(0.00)</u>	\$	<u>(0.04)</u>	\$	<u>(0.00)</u>
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC AND DILUTED		<u>160,077,510</u>		<u>102,347,964</u>		<u>158,595,814</u>

See notes to condensed financial statements.

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WATER CHEF, INC.
(A Development Stage Company Commencing January 1, 2002)
CONDENSED STATEMENT OF STOCKHOLDERS' DEFICIENCY
(UNAUDITED)

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	Preferred Stock		Common Stock	
	Shares	Amount	Shares	Amount
FOR THE SIX MONTHS ENDED JUNE 30, 2005				
BALANCE - JANUARY 1, 2005	614,413	\$ 615	155,885,727	\$
Proceeds from sale of common stock (\$0.05 per share) March 21, 2005	--	--	200,000	
Preferred stock converted to common stock During the quarter ended March 31, 2005	(55,970)	(56)	2,518,800	
Extension of 1,666,667 warrants June 7, 2005	--	--	--	
Proceeds from sale of common stock (\$0.06 per share) May 12, 2005	--	--	500,000	
(\$0.05 per share) May 12, 2005	--	--	200,000	
Common stock issued for services (\$0.05-\$0.10 Per share) March 21, 2005	--	--	230,000	
Preferred stock converted to common stock during the quarter ended June 30, 2005	(34,020)	(34)	1,360,800	
Preferred stock dividend	--	--	--	
Net loss	--	--	--	
BALANCE - JUNE 30, 2005	524,423	\$ 525	160,895,327	\$

See notes to condensed financial statements.

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WATER CHEF, INC.
(A Development Stage Company Commencing January 1, 2002)
CONDENSED STATEMENT OF STOCKHOLDERS' DEFICIENCY
(UNAUDITED)
(Continued)

	Treasury Stock -at cost	Deficit Accumulated Through December 31, 2001	Deficit Accumulated During Development Stage	St D
FOR THE SIX MONTHS ENDED JUNE 30, 2005				
BALANCE - JANUARY 1, 2005	\$ (5,768)	\$ (14,531,596)	\$ (8,883,027)	\$

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Proceeds from sale of common stock (\$0.05 per share) March 21, 2005	--	--	--
Preferred stock converted to common stock during the quarter ended March 31, 2005	--	--	--
Extension of 1,666,667 warrants June 7, 2005	--	--	--
Proceeds from sale of common stock (\$0.05 per share) May 12, 2005	--	--	--
(\$0.06 per share) May 12, 2005	--	--	--
Common stock issued for services (\$0.05-\$0.10 per share) March 21, 2005	--	--	--
Preferred stock converted to common stock During the quarter ended June 30, 2005	--	--	--
Preferred stock dividend	--	--	--
Net loss	--	--	(434,680)
	-----	-----	-----
BALANCE - JUNE 30, 2005	\$ (5,768)	\$ (14,531,596)	\$ (9,317,707)
	=====	=====	=====

See notes to condensed financial statements.

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WATER CHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)
CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Six Months Ended June 30,		For the Period January 1, 2002 to June 30, 2005
	2005	2004	
	-----	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	\$ (434,680)	\$ (2,812,761)	\$ (9,317,707)
Adjustments to reconcile net loss to net cash used in operating activities:			
Amortization of patents	927	927	6,489
Non-cash stock-based compensation	18,000	182,387	741,563
Non-dilution agreement termination cost	--	(223,860)	2,462,453
Financing cost - warrant extension	74,700	94,151	168,851
Loss on settlement of debt	--	2,313,716	2,519,866
Inventory reserve	--	--	159,250
Write-off of stock subscription receivable	--	--	21,800
Changes in assets and liabilities:			
Inventory	(30,000)	13,250	(30,000)

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Prepaid expenses	6,819	(41,912)	46,206
Accounts payable, accrued expenses, accrued dividends and customer deposits	213,494	60,389	1,263,283
	-----	-----	-----
NET CASH USED IN OPERATING ACTIVITIES	(150,740)	(413,713)	(1,957,946)
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:			
Stock subscription receivable	20,000	--	65,700
Proceeds from sale of preferred stock	--	412,756	1,130,127
Proceeds from sale of common stock	50,000	--	527,600
Proceeds from sale of common stock to be issued	--	--	200,000
	-----	-----	-----
NET CASH PROVIDED BY FINANCING ACTIVITIES	70,000	412,756	1,923,427
	-----	-----	-----
NET DECREASE IN CASH	(80,740)	(957)	(34,519)
	-----	-----	-----
CASH AT BEGINNING OF PERIOD	81,732	102,831	35,511
	-----	-----	-----
CASH AT END OF PERIOD	\$ 992	\$ 101,874	\$ 992
	=====	=====	=====

See notes to condensed financial statements.

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WATERCHEF, INC.
(A Development Stage Company Commencing January 1, 2002)
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - DESCRIPTION OF BUSINESS

Water Chef, Inc. (the "Company"), is a Delaware corporation currently engaged in the design and marketing of water dispensers and purification equipment both inside and outside the United States. The Company's corporate headquarters are located in Glen Head, New York.

NOTE 2 - BASIS OF PRESENTATION AND ACCOUNTING POLICIES

The accompanying unaudited condensed interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, these interim financial statements do not include all of the information and footnotes required for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to make the financial statements not misleading have been included.

The operating results for the six-month period ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. These financial statements should be read in conjunction with the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB, filed on April 6, 2005, for the year ended December 31, 2004.

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DEVELOPMENT STAGE COMPANY

The Company is in the development stage as defined by Statement of Financial Accounting Standards ("SFAS") Statement No. 7, "Accounting and Reporting for Development Stage Companies." To date, the Company has generated limited sales and has devoted its efforts primarily to developing its products, implementing its business and marketing strategy and raising working capital through equity financing or short-term borrowings.

REVENUE RECOGNITION

The Company recognizes its revenues when the product is shipped and or title passes and collection is reasonably assured.

STOCK BASED COMPENSATION

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company will continue to account for stock-based compensation according to the Accounting Principles Board ("APB") Opinion No. 25.

The following table summarizes relevant information as to reported results under the Company's intrinsic value method of accounting for stock awards, with supplemental information as if the fair value recognition provisions of SFAS No.123 had been applied for the periods ended June 30, 2005 and 2004 as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Net loss applicable to common stockholder as reported	\$ (473,242)	\$ (4,360,675)	\$ (521,323)	\$ (4,360,675)
Add:				
Stock-based employee compensation adjustment, included in reported net loss	--	--	--	--
Less:				
Stock-based employee compensation cost net of tax effect under fair-value accounting	--	44,656	--	--
Pro-forma net loss under fair value method	\$ (473,242)	\$ (4,405,331)	\$ (521,323)	\$ (4,360,675)
Loss per share - basic and diluted, as reported	\$ (0.00)	\$ (0.04)	\$ (0.00)	\$ (0.04)
Pro-forma loss per share - basic and diluted	\$ (0.00)	\$ (0.04)	\$ (0.00)	\$ (0.04)

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WATERCHEF, INC.

(A Development Stage Company Commencing January 1, 2002)

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 3 - GOING CONCERN

The accompanying interim condensed financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred recurring losses from operations, an accumulated deficit since inception of approximately \$23,849,000 and has a working capital deficiency of approximately \$2,839,000 at June 30, 2005. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with respect to these matters include restructuring its existing debt, settling its existing debt by issuing shares of its common stock and raising additional capital through future issuance of stock and or debentures. However, there can be no assurance that the Company will be able to obtain sufficient funds to continue the development of its product, marketing plan and distribution network.

The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

NOTE 4 - RECENT ACCOUNTING STANDARDS

In May 2005, the FASB issued SFAS 154--Accounting Changes and Error Corrections--a replacement of APB Opinion No. 20 and FASB Statement No. 3. This statement replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management is evaluating the impact of this pronouncement on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment." This statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS No.123R addresses all forms of share based payment ("SBP") awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS No.123R, SBP awards result in a cost that will be measured at fair value on the awards' grant dates, based on the estimated number of awards that are expected to vest. This statement is effective for public entities that file as small business issuers - as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The adoption of this pronouncement is not expected to have a material effect on the Company's financial statements.

NOTE 5 - NET LOSS PER SHARE OF COMMON STOCK

Basic loss per share was computed using the weighted average number of outstanding common shares. Diluted loss per share includes the effect of dilutive common stock equivalents from the assumed exercise of options, warrants and convertible preferred stock. Common stock equivalents were excluded in the computation of diluted loss per share since their inclusion would be

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anti-dilutive. Total shares issuable upon the exercise of options, warrants and conversion of preferred stock for the six months ended June 30, 2005 and 2004 were 30,638,912 and 46,863,796, respectively.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

Leases

The Company leases its administrative facilities, located in Glen Head, New York, on a month-to-month basis.

NOTE 7 - COMMON STOCK ISSUED

Cash

During the six months ended June 30, 2005, the Company raised \$50,000 through the sale of 900,000 shares of common stock.

Services

During the six months ended June 30, 2005, the Company issued 230,000 shares of common stock for services for a value of \$18,000.

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Conversion of preferred stock into common stock

During the six months ended June 30, 2005, the Company issued to various parties 3,879,600 shares of common stock in connection with the conversion of preferred stock.

Extension of warrants

During the quarter ended June 30, 2005, the Company extended the life of 1,666,667 warrants for a period of 12 months. The warrants will expire in June 2006. The Company recorded a finance charge of \$74,700 for the three and six months ended June 30, 2005.

NOTE 8- MAJOR CUSTOMERS / CREDIT RISK

During the six month period ended June 30, 2005, the Company sold five units to two customers and recognized revenues of \$260,000. During the six month period ended June 30, 2004, the Company sold one unit to one customer and recognized revenues of \$56,290. During the three month period June 30, 2005 and 2004, there were no units sold.

The Company maintains cash deposits with financial institutions, which from time to time may exceed federally insured limits. The Company has not experienced any losses and believes it is not exposed to any significant credit risk from cash. At June 30, 2005 the Company did not have cash balances on deposit that exceeded the federally insured limits.

NOTE 9- SUBSEQUENT EVENTS

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- o Subsequent to June 30, 2005, the Company issued 2,455,357 shares of restricted common stock for gross proceeds of \$205,000. The restricted common stock was issued to various parties at an average share price of \$0.09 per share.
- o Subsequent to June 30, 2005, the Company issued 571,428 shares of restricted common stock for the settlement of approximately \$40,000 of notes payable.

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ITEM 2 - MANagements DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion and analysis of financial condition and results of operations of the Company should be read in conjunction with the Company's Financial Statements and related Footnotes.

Forward-Looking Statements

Management's discussion and analysis of financial condition and results of operations and other sections of this Report contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend for the forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Company's expected financial position, business and financing plans are forward-looking statements. Such forward-looking statements are identified by use of forward-looking words such as "anticipates," "believes," "plans," "estimates," "expects," and "intends" or words or phrases of similar expression. These forward-looking statements are subject to various assumptions, risks and uncertainties, including but not limited to, changes in political and economic conditions, demand for the Company's products, acceptance of new products, technology developments affecting the Company's products and to those discussed in the Company's filings with the Securities and Exchange Commission. Accordingly, actual results could differ materially from those contemplated by the forward-looking statements.

Introduction

Until the fourth quarter of 2001, Water Chef was engaged in the manufacture and marketing of water coolers and water purification and filtration products. In the fourth quarter of 2001, the Company completed the sale of this business in order to focus its activities on its PureSafe line of business. The PureSafe Water Station has been designed by the Company to meet the needs of communities which either do not have access to municipal water treatment systems, or for those which systems have been compromised, either by environmental factors or by faulty design or maintenance.

Results of Operations

Revenue for the six months ended June 30, 2005 and June 30, 2004 was \$260,000 and \$56,290, respectively. During the six months ended June 30, 2005, the Company recognized the sale of five PureSafe Water Station Systems. Four of these systems are to be used in Ecuador, and the fifth system was purchased by a humanitarian buyer to be used as part of the tsunami relief effort in Sri Lanka. In addition, Water Chef received deposits of \$115,000 during the first three months of 2005 for relief effort systems that will be shipped in 2005.

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Cost of sales for the six month periods ended June 30, 2005 and June 30, 2004 were \$21,000 and \$53,250 respectively. The costs of the units sold during 2005 were previously written off. An analysis of the components of cost of sales in the 2005 and 2004 periods follows:

Cost of Sales Period	Product CGS	Rent and Overhead Payments to Manufacturer	Total
For the six months ended June 30, 2005	\$ --	\$ 21,000	\$ 21,000
For the six months ended June 30, 2004	\$13,250	\$ 40,000	\$ 53,250

Selling, general and administrative expenses for the six months ended June 30, 2005 were \$645,206, compared to \$556,680 for the six months ended June 30, 2004, an increase of 16% primarily caused by an increase in commissions associated with the sales of PureSafe Water Station Systems as described above. During the quarter ended June 30, 2005, the Company extended the life of 1,666,667 warrants for a period of 12 months. Their warrants will expire in June 2006. The Company recorded a finance charge of \$74,700 for the three and six months ended June 30, 2005.

The net loss for the six months ended June 30, 2005 was \$434,680 compared to \$2,812,761 in the same period ended June 30, 2004.

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Liquidity and Capital Resources

At June 30, 2005, the Company had a working capital deficiency of approximately \$2,839,000. In addition, the Company continues to incur recurring losses from operations and has an accumulated deficit since inception of approximately \$23,849,000. The accompanying financial statements have been prepared assuming that that the Company will continue as a going concern. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with respect to these matters include restructuring its existing debt, raising additional capital through future issuances of stock and/or equity, and finding sufficient profitable markets for its products to generate sufficient cash to meet its business obligations. However, there can be no assurance that the Company will be able to obtain sufficient funds to continue the development of its product, marketing plan and distribution network.

The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

Recent Accounting Standards

In May 2005, the Financial Accounting Standards Board ("FASB") issued Statement of Accounting Standards ("SFAS") No. 154--"Accounting Changes and Error Corrections"--a replacement of Accounting Principles Board ("APB") Opinion No. 20 and SFAS No. 3. This statement replaces APB Opinion No. 20, "Accounting Changes", and FASB Statement No. 3, "Reporting Accounting Changes in Interim

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Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management is evaluating the impact of this pronouncement on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment." This statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS No.123R addresses all forms of share based payment ("SBP") awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS No.123R, SBP awards result in a cost that will be measured at fair value on the awards' grant dates, based on the estimated number of awards that are expected to vest. This statement is effective for public entities that file as small business issuers - as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The adoption of this pronouncement is not expected to have a material effect on the Company's financial statements.

ITEM 3 - CONTROLS AND PROCEDURES

Evaluation and Disclosure Controls and Procedures

The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures," as such term is defined in Rules 13a-15e promulgated under the Securities Exchange Act of 1934, as amended, as of this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer has concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

Management is aware that there is a lack of segregation of duties at the Company due to the small number of employees dealing with general administrative and financial matters. This constitutes a material weakness in the financial reporting. However, at this time management has decided that considering the employees involved and the control procedures in place, the risks associated with such lack of segregation are insignificant and the potential benefits of adding additional employees to clearly segregate duties do not justify the expenses associated with such increases. Management will periodically reevaluate this situation. If the volume of the business increases and sufficient capital is secured, it is the Company's intention to increase staffing to mitigate the current lack of segregation of duties within the general administrative and financial functions.

Changes in Internal Controls

There have been no changes in internal controls or in other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Limitations on the Effectiveness of Controls

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a Company have been detected.

PART 11 - OTHER INFORMATION

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the six months ended June 30, 2005, the Company raised \$50,000 through the sale of 900,000 shares of common stock.

During the six months ended June 30, 2005, the Company issued an aggregate of 230,000 shares of its Common stock for professional services totaling \$18,000.

During the six months ended June 30, 2005, the Company issued various parties 3,879,600 shares of common stock in connection with the conversion of preferred stock.

The Company issued these shares in reliance on the exemption from registration afforded by Section 4(2) of the Securities Act of 1933 and Regulation D promulgated thereunder. These shares were offered to less than 35 "non-accredited" investors and were purchased for investment purposes with no view to resale.

ITEM 6 - EXHIBITS

Exhibit No. -----	Description -----
14.1	Code of Ethics
31	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 8 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURE

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

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Water Chef, Inc.

Date 8/12/05

/s/ David A. Conway

David A. Conway
President, Chief Executive
Officer, and Chief Financial
Officer
(Principal Operating Officer)

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

FORM 10-QSB

(Mark One)

(X) QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES AND EXCHANGE
ACT OF 1934

For the quarterly period ended September 30, 2005

() TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE EXCHANGE ACT

For the transition period from to

Commission file number 1-09478

WATER CHEF, INC.

(Exact name of small business issuer as specified in its charter)

Delaware

86-0515678

(State of other jurisdiction of
incorporation or organization)

(IRS Employer
Identification No.)

1007 Glen Cove Avenue, Suite 1, Glen Head, New York 11545

(Address of principal executive offices)

516-656-0059

(Issuer's telephone number)

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

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

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

State the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date.

OUTSTANDING AS OF NOVEMBER 8, 2005

CLASS -----	Common -----
Par value \$0.001 per share	178,738,154

Transitional Small Business Disclosure Format (check one): Yes [] No [X]

WATER CHEF, INC.

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WATER CHEF, INC.
 (A Development-Stage Company Commencing January 1, 2002)
 CONDENSED BALANCE SHEET
 AT SEPTEMBER 30, 2005
 (UNAUDITED)

ASSETS

CURRENT ASSETS:	
Cash	\$ 2,883
Inventory	30,000
Prepaid expenses	8,754

TOTAL CURRENT ASSETS	41,637

OTHER ASSETS:	
Patents and trademarks - net of accumulated amortization of \$8,334	17,721
Other assets	3,162

TOTAL OTHER ASSETS	20,883

TOTAL ASSETS	\$ 62,520
	=====

LIABILITIES AND STOCKHOLDERS' DEFICIENCY

CURRENT LIABILITIES:	
Accounts payable	\$ 222,307
Accrued expenses and other current liabilities	1,346,938
Notes payable (including accrued interest of \$518,850)	1,187,072
Accrued dividends payable	146,732
Customer deposit	115,000

TOTAL CURRENT LIABILITIES	3,018,049

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LONG-TERM LIABILITIES:

Loans payable to stockholder (including accrued interest of \$123,122) 495,903

TOTAL LIABILITIES 3,513,952

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' DEFICIENCY:

Preferred stock - \$.001 par value; 10,000,000 shares authorized; 237,773 shares issued and outstanding, (liquidation preference \$1,112,250) 238

Common stock - \$.001 par value; 190,000,000 shares authorized; 177,304,697 shares issued and 177,300,297 shares outstanding 177,305

Additional paid-in capital 20,559,577

Treasury stock, at cost - 4,400 shares of common stock (5,768)

Deficit accumulated through December 31, 2001 (14,531,596)

Deficit accumulated during development stage (9,651,188)

TOTAL STOCKHOLDERS' DEFICIENCY (3,451,432)

TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY \$ 62,520

See notes to condensed financial statements.

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WATER CHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)
CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the Three Months Ended September 30,		For the Ni Sept
	2005	2004	2005
SALES	\$ --	\$ --	\$ 260,000
COST OF SALES	21,000	24,000	2,000
GROSS (LOSS) PROFIT	(21,000)	(24,000)	218,000

SELLING, GENERAL AND ADMINISTRATIVE -
Including stock based compensation of \$0 and \$0 for the three months ended September 30, 2005 and 2004 and \$18,000 and \$311,037 for the nine month ended September 30, 2005 and 2004, and \$741,563 for the period

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January 1, 2002 to September 30, 2005, respectively	275,299	428,357	920,505
NON-DILUTION AGREEMENT TERMINATION COST	--	--	--
INTEREST EXPENSE - including interest expense to a related party of \$5,967 and \$17,901 for three and nine months ended September 30, 2005 and 2004, respectively and \$89,505 for the period January 1, 2002 through September 30, 2005	37,182	37,557	112,296
LOSS ON SETTLEMENT OF DEBT	--	--	--
FINANCING COST - EXTENSION OF WARRANTS	--	--	74,700
STOCK APPRECIATION RIGHTS - REDUCTION IN VALUE	--	--	(121,340)
NET LOSS	(333,481)	(489,914)	(768,161)
DEEMED DIVIDEND ON PREFERRED STOCK	--	--	--
PREFERRED STOCK DIVIDENDS	(34,909)	(47,398)	(121,552)
NET LOSS APPLICABLE TO COMMON STOCKHOLDERS	\$ (368,390)	\$ (537,312)	\$ (889,713)
BASIC AND DILUTED LOSS PER COMMON SHARE	\$ (0.00)	\$ (0.00)	\$ (0.01)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC AND DILUTED	168,354,650	142,188,759	161,884,506

See notes to condensed financial statements.

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WATER CHEF, INC.
(A Development Stage Company Commencing January 1, 2002)
CONDENSED STATEMENT OF STOCKHOLDERS' DEFICIENCY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005
(UNAUDITED)

	Preferred Stock		Common S
	Shares	Amount	Shares
BALANCE - JANUARY 1, 2005	614,413	\$ 615	155,885,727
Proceeds from sale of common stock			
(\$0.05 per share) - March 21, 2005	--	--	200,000
(\$0.06 per share) - May 12, 2005	--	--	500,000
(\$0.05 per share) - May 12, 2005	--	--	200,000

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(\$0.07 per share) - July 14, 2005	--	--	714,286
(\$0.08 per share) - July 14, 2005	--	--	312,500
(\$0.10 per share) - July 14, 2005	--	--	1,000,000
(\$0.07 per share) - August 5, 2005	--	--	428,571
Common stock issued for services			
(\$0.05-\$0.10 Per share) - March 21, 2005	--	--	230,000
Common stock issued in repayment of debt			
(\$0.07 per share) - July 14, 2005	--	--	571,428
Preferred stock converted to common stock			
During the quarter ended March 31, 2005	(55,970)	(56)	2,518,800
During the quarter ended June 30, 2005	(34,020)	(34)	1,360,800
During the quarter ended September 30, 2005	(286,650)	(287)	13,382,585
Extension of 1,666,667 warrants - June 7, 2005	--	--	--
Preferred stock dividend	--	--	--
Net loss	--	--	--
	-----	-----	-----
BALANCE - SEPTEMBER 30, 2005	237,773	\$ 238	177,304,697
	=====	=====	=====

See notes to condensed financial statements

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WATER CHEF, INC.
(A Development Stage Company Commencing January 1, 2002)
CONDENSED STATEMENT OF STOCKHOLDERS' DEFICIENCY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005
(UNAUDITED)
(Continued)

	Treasury Stock	Deficit Accumulated Through December 31, 2001	Deficit Accumulated During Development Stage
	-----	-----	-----
BALANCE - JANUARY 1, 2005	\$ (5,768)	\$ (14,531,596)	\$ (8,883,027)
Proceeds from sale of common stock			
(\$0.05 per share) - March 21, 2005	--	--	--
(\$0.06 per share) - May 12, 2005	--	--	--
(\$0.05 per share) - May 12, 2005	--	--	--
(\$0.07 per share) - July 14, 2005	--	--	--
(\$0.08 per share) - July 14, 2005	--	--	--
(\$0.10 per share) - July 14, 2005	--	--	--
(\$0.07 per share) - August 5, 2005	--	--	--

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Common stock issued in for services (\$0.05-\$0.10 per share) - March 21, 2005	--	--	--
Common stock issued in repayment of debt (\$0.07 per share) - July 14, 2005	--	--	--
Preferred stock converted to common stock			
During the quarter ended March 31, 2005	--	--	--
During the quarter ended June 30, 2005	--	--	--
During the quarter ended September 30, 2005	--	--	--
Extension of 1,666,667 warrants - June 7, 2005	--	--	--
Preferred stock dividend	--	--	--
Net loss	--	--	(768,161)
BALANCE - SEPTEMBER 30, 2005	\$ (5,768)	\$ (14,531,596)	\$ (9,651,188)

See notes to condensed financial statements.

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WATER CHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)

CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Nine Months Ended September 30,		For the Period January 1, 2002 (Inception) to September 30, 2005
	2005	2004	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	\$ (768,161)	\$ (3,302,675)	\$ (9,651,188)
Adjustments to reconcile net loss to net cash used in operating activities:			
Amortization of patents	1,390	1,391	6,952
Non-cash stock-based compensation	18,000	311,037	741,563
Non-dilution agreement termination cost	--	(223,860)	2,462,453
Financing cost - warrant extension	74,700	94,151	168,851
Loss on settlement of debt	--	2,313,716	2,519,866
Inventory reserve	--	--	159,250
Write-off of stock subscription receivable	--	--	21,800
Changes in assets and liabilities:			
Inventory	(30,000)	26,500	(30,000)
Prepaid expenses	8,359	(10,025)	47,746
Accounts payable, accrued expenses, accrued dividends and customer deposits	341,863	125,523	1,391,652

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NET CASH USED IN OPERATING ACTIVITIES	(353,849)	(664,242)	(2,161,055)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Stock subscription receivable	20,000	--	65,700
Proceeds from sale of preferred stock	--	412,756	1,130,127
Proceeds from sale of common stock	255,000	207,600	732,600
Proceeds from sale of common stock to be issued	--	--	200,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	275,000	620,356	2,128,427
NET DECREASE IN CASH	(78,849)	(43,886)	(32,628)
CASH AT BEGINNING OF PERIOD	81,732	102,831	35,511
CASH AT END OF PERIOD	\$ 2,883	\$ 58,945	\$ 2,883
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITY:			
Common stock issued for repayment of debt	\$ 40,000	\$ --	\$ 40,000

See notes to condensed financial statements.

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WATER CHEF, INC.
(A Development Stage Company Commencing January 1, 2002)

NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - DESCRIPTION OF BUSINESS

Water Chef, Inc. (the "Company"), is a Delaware corporation currently engaged in the design and marketing of water dispensers and purification equipment both inside and outside the United States. The Company's corporate headquarters are located in Glen Head, New York.

NOTE 2 - BASIS OF PRESENTATION AND ACCOUNTING POLICES

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, these financial statements do not include all of the information and footnotes required for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to make the financial statements not misleading have been included.

The operating results for the nine-month period ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. These financial statements should be read in conjunction with the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB, filed on April 6, 2005, for the year ended December 31,

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2004.

DEVELOPMENT STAGE COMPANY

The Company is in the development stage as defined by Statement of Financial Accounting Standards ("SFAS") Statement No. 7, "Accounting and Reporting for Development Stage Companies." To date, the Company has generated limited sales and has devoted its efforts primarily to developing its products, implementing its business and marketing strategy and raising working capital through equity financing or short-term borrowings.

REVENUE RECOGNITION

The Company recognizes its revenue when products are shipped and collection is reasonably assured.

STOCK BASED COMPENSATION

In December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company will continue to account for stock-based compensation according to Accounting Pronouncement Board ("APB") Opinion No. 25.

The following table summarizes relevant information as to reported results under the Company's intrinsic value method of accounting for stock awards, with supplemental information as if the fair value recognition provisions of SFAS No. 123 had been applied for the periods ended September 30, 2005 and 2004 as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net loss applicable to common stockholders, as reported	\$ (368,390)	\$ (537,312)	\$ (889,713)	\$ (5,548)
ADD:				
Stock-based employee compensation, included in reported loss	--	--	--	--
LESS:				
Stock based employee compensation cost, net of tax effect under fair value accounting	--	44,636	--	125,000
Pro-forma net loss under fair value method	\$ (368,390)	\$ (581,968)	\$ (889,713)	\$ (5,673,000)
Loss per share - basic and diluted, as reported	\$ (0.00)	\$ (0.00)	\$ (0.01)	\$ (0.00)
Pro-forma loss per share - basic and diluted	\$ (0.00)	\$ (0.00)	\$ (0.01)	\$ (0.00)

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WATER CHEF, INC.

(A Development Stage Company Commencing January 1, 2002)

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 3 - GOING CONCERN

The accompanying condensed financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred recurring losses from operations, an accumulated deficit since its inception of approximately \$24,183,000 and has a working capital deficiency of approximately \$2,976,000 at September 30, 2005. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with respect to these matters include restructuring its existing debt, settling its existing debt by issuing shares of its common stock and raising additional capital through future issuance of stock and or debentures. However, there can be no assurance that the Company will be able to obtain sufficient funds to continue the development of its product, marketing plan and distribution network.

The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

NOTE 4 - RECENT ACCOUNTING STANDARDS

In May 2005, the FASB issued SFAS 154 - Accounting Change and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3. This statement replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This statement is effective for accounting changes and corrects errors made in fiscal years beginning after December 15, 2005. Management is evaluating the impact of this pronouncement on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment." This statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS No. 123R addresses all forms of share based payment ("SBP") awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS No. 123R, SBP awards result in a cost that will be measured at fair value on the awards' grant dates, based on the estimated number of awards that are expected to vest. This statement is effective for public entities that file as small business issuers - as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The adoption of this pronouncement is not expected to have a material effect on the Company's financial statements

NOTE 5 - NET INCOME (LOSS) PER SHARE OF COMMON STOCK

Basic loss per share was computed using the weighted average number of outstanding common shares. Diluted loss per share includes the effect of dilutive common stock equivalents from the assumed exercise of options, warrants and convertible preferred stock. Common stock equivalents were excluded in the

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computation of diluted loss per share since their inclusion would be anti-dilutive. Total shares issuable upon the exercise of options, warrants and conversion of preferred stock for the nine months ended September 30, 2005 and 2004 were 17,256,233 and 37,555,044, respectively.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

Leases

The Company leases its administrative facilities, located in Glen Head, New York, on a month-to-month basis.

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WATER CHEF, INC.

(A Development Stage Company Commencing January 1, 2002)

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 7 - COMMON STOCK ISSUED

Cash

During the nine months ended September 30, 2005, the Company raised \$255,000 through the sale of 3,355,357 shares of common stock.

Services

During the nine months ended September 30, 2005, the Company issued 230,000 shares of common stock for services for a value of \$18,000.

Debt

During the nine months ended September 30, 2005, the Company issued 571,428 shares of common stock to pay-down \$40,000 of its debt and accrued interest.

Conversion of preferred stock into common stock

During the nine months ended September 30, 2005, the Company issued various parties 17,262,185 shares of common stock in connection with the conversion of preferred stock.

Extension of warrants

In June 2005, the Company extended the life of 1,666,667 warrants for a period of 12 months. The warrants will expire in June 2006. The Company recorded a finance charge of \$74,700 for the nine months ended September 30, 2005.

NOTE 8- MAJOR CUSTOMERS/CREDIT RISK

During the nine month period ended September 30, 2005, the Company sold five

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units to two customers and recognized revenues of \$260,000. During the nine month period ended September 30, 2004, the Company sold one unit to one customer and recognized revenues of \$56,290. During the three month period ended September 30, 2005 and 2004, there were no units sold.

The Company maintains cash deposits with financial institutions, which from time to time may exceed federally insured limits. The Company has not experienced any losses and believes it is not exposed to any significant credit risk from cash. At September 30, 2005, the Company did not have cash balances on deposit that exceeded the federally insured limits.

NOTE 9- SUBSEQUENT EVENTS

Subsequent to September 30, 2005, the Company issued 100,000 shares of its common stock to a note holder for an agreement to defer requesting payment for a period of one month. The principal amount of the note is \$400,000, and accrued interest is approximately \$423,000. The share issuance will be accounted for as additional interest expense during the fourth quarter.

Subsequent to September 30, 2005, the Company issued 132,500 shares of common stock to a vendor for settlement of \$6,625 of accounts payable.

Subsequent to September 30, 2005, the Company issued 1,080,357 shares of its common stock for \$75,625 of cash.

Subsequent to September 30, 2005, the Company issued 125,000 shares of its common stock for services with a value of \$7,500.

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ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion and analysis of financial condition and results of operations of the Company should be read in conjunction with the Company's financial statements and related footnotes.

Forward-Looking Statements

Management's discussion and analysis of financial condition and results of operations and other sections of this Report contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We intend for the forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Company's expected financial position, business and financing plans are forward-looking statements. Such forward-looking statements are identified by use of forward-looking words such as "anticipates," "believes," "plans," "estimates," "expects," and "intends" or words or phrases of similar expression. These forward-looking statements are subject to various assumptions, risks and uncertainties, including but not limited to, changes in political and economic conditions, demand for the Company's products, acceptance of new products, technology developments affecting the Company's products and to those discussed in the Company's filings with the Securities and Exchange Commission. Accordingly, actual results could differ materially from those contemplated by the forward-looking statements.

Introduction

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Until the fourth quarter of 2001, Water Chef was engaged in the manufacture and marketing of water coolers and water purification and filtration products. In the fourth quarter of 2001, the Company completed the sale of this business in order to focus its activities on its PureSafe line of business. The PureSafe Water Station has been designed by the Company to meet the needs of communities who either do not have access to municipal water treatment systems, or for those whose systems have been compromised, either by environmental factors or by faulty design or maintenance.

Results of Operations

Sales for the nine months ended September 30, 2005 and September 30, 2004 were \$260,000 and \$56,290 respectively. During the nine months ended September 30, 2005, the Company recognized the sale of five PureSafe Water Station Systems. Four of these systems were purchased for use in Ecuador, and the fifth system was purchased by a humanitarian buyer to be used as part of the tsunami relief effort in Sri Lanka. In addition, Water Chef received deposits of \$115,000 during the first three months of 2005 for relief effort systems that will be shipped in 2005.

Cost of sales for the nine month periods ended September 30, 2005 and 2004 were \$42,000 and \$77,250 respectively. The cost of the units sold during 2005 was previously written off. An analysis of the components of cost of sales in the 2005 and 2004 periods follows:

Cost of Sales Period	Product CGS	Rent and Overhead Payments to Manufacturer	Total
For the nine months ended September 30, 2005	\$ --	\$ 42,000	\$ 42,000
For the nine month ended September 30, 2004	\$ 13,250	\$ 64,000	\$ 77,250

Selling, general and administrative expenses for the nine months ended September 30, 2005 were \$920,505, compared to \$985,037 for the nine months ended September 30, 2004, a decrease of 7%.

The net loss for the nine months ended September 30, 2005 was \$768,161 compared to \$3,302,675 in the same period ended September 30, 2004.

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Liquidity and Capital Resources

At September 30, 2005, the Company had a working capital deficiency of approximately \$2,976,000. In addition, the Company continues to suffer recurring losses from operations and has an accumulated deficit since inception of approximately \$24,183,000. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with respect to these matters include restructuring its existing debt, raising additional capital through future issuances of stock and/or equity, and finding sufficient profitable markets for its products to generate sufficient cash to meet its business obligations.

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However, there can be no assurance that the Company will be able to obtain sufficient funds to continue the development of its product, marketing plan and distribution network.

The accompanying condensed financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

Recent Accounting Standards

In May 2005, the FASB issued SFAS 154 - Accounting Change and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3. This statement replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provision, those provisions should be followed. This statement is effective for accounting changes and corrects in errors made in fiscal years beginning after December 15, 2005. Management is evaluating the impact of this pronouncement on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment." This statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and its related implementation guidance. SFAS No. 123R addresses all forms of share based payment ("SBP") awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS No. 123R, SBP awards result in a cost that will be measured at fair value on the awards' grant dates, based on the estimated number of awards that are expected to vest. This statement is effective for public entities that file as small business issuers - as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The adoption of this pronouncement is not expected to have a material effect on the Company's financial statements.

ITEM 3 - CONTROLS AND PROCEDURES

Evaluation and Disclosure Controls and Procedures

The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures," as such term is defined in Rules 13a-15e promulgated under the Exchange Act as of this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer has concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

Management is aware that there is a lack of segregation of duties at the Company due to the small number of employees dealing with general administrative and financial matters. This constitutes a material weakness in the financial reporting. However, at this time management has decided that considering the employees involved and the control procedures in place, the risks associated with such lack of segregation are insignificant and the potential benefits of

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adding additional employees to clearly segregate duties do not justify the expenses associated with such increases. Management will periodically reevaluate this situation. If the volume of the business increases and sufficient capital is secured, it is the Company's intention to increase staffing to mitigate the current lack of segregation of duties within the general administrative and financial functions.

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Changes in Internal Controls

There have been no changes in internal controls or in other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Limitations on the Effectiveness of Controls

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a Company have been detected.

PART 11 - OTHER INFORMATION

ITEM 2 - CHANGES IN SECURITIES AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

During the nine months ended September 30, 2005, the Company raised \$255,000 through the sale of 3,355,357 shares of common stock.

During the nine months ended September 30, 2005, the Company issued 230,000 shares of common stock for services for a value of \$18,000.

During the nine months ended September 30, 2005, the Company issued 571,428 shares of common stock to pay-down \$40,000 of its debt and accrued interest.

During the nine months ended September 30, 2005, the Company issued various parties 17,262,185 shares of common stock in connection with the conversion of preferred stock.

The Company issued these shares in reliance on the exemption from registration afforded by Section 4(2) of the Securities Act of 1933 and Regulation D promulgated there under. These shares were offered to less than 35 "non-accredited" investors and were purchased for investment purposes with no view to resale.

ITEM 6 - EXHIBITS

Exhibit No.	Description
14.1	Code of Ethics
31	Certificate of Chief Executive Officer and Chief Financial

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Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002

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Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 8 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURE

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

Water Chef, Inc.

/s/ David A. Conway

Date November 8, 2005

David A. Conway
President, Chief Executive
Officer, and Chief Financial
Officer
(Principal Operating Officer)

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

FORM 10-KSB
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Year Ended December 31, 2005

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 0-30544

WATER CHEF, INC

(Name of small business issuer in its charter)

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DELAWARE

86-0515678

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

1007 GLEN COVE AVENUE, SUITE 1
GLEN HEAD, NY 11545

(Address of principal executive offices) (Zip Code)

(516) 656-0059

(Issuer's telephone number)

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

Securities registered under section 12 (g) of the Exchange Act: Common
stock, Par value \$.001

Redeemable Common Stock Purchase Warrants.

Check whether the issuer is not required to file reports pursuant to Section 13
or 15(d) of the Exchange Act.

Check whether the Issuer (1) filed all reports required to be filed by Section
13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter
period that the registrant was required to file such reports) and (2) has been
subject to such filing requirements for the past 90 days

YES X NO

--- ---

Check if there is no disclosure of delinquent filers in response to Item 405 of
Regulation S-B is contained in this form, and no disclosure will be contained,
to the best of registrant's knowledge, in definitive proxy or information
statements incorporated by reference in Part III of this Form 10-KSB or any
amendment to this Form 10-KSB.

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

--- ---

The issuer's net sales for the most recent fiscal year were \$260,000.

The aggregate market value of the voting stock held by non-affiliates based upon
the last sale price on March 15, 2006 was approximately \$16,338,557.

As of March 15, 2006, the Registrant had 182,547,785 shares of its Common Stock,
\$.001 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

Transitional Small Business Disclosure Format (Check one): YES NO X

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WATER CHEF, INC.

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ANNUAL REPORT ON FORM 10-KSB

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ITEM 1. DESCRIPTION OF BUSINESS

THE COMPANY

Water Chef, Inc. (the "Company," "Water Chef"), designs and markets water purification equipment. Water coolers and filters were a substantial part of the Company's business from 1993 until the fourth quarter of 2001, at which time this business was sold so that Water Chef could concentrate on the further

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development, manufacturing, and marketing of their patented line of "PureSafe" water purification systems. The accompanying financial statements have been prepared assuming the Company will continue as a going concern. To date, the Company has shipped 26 PureSafe units. Revenue has been recognized on only 8 PureSafe units, as 18 units that were shipped to the Kingdom of Jordan have not met the criteria for revenue recognition due to no reasonable assurance of collectibility. In addition to those units shipped in 2005, the Company received payment in 2005 for two additional units that will ship in 2006.

BACKGROUND

The Company was originally incorporated under Arizona law in 1985 and merged into a Delaware corporation in 1987. In 1993, the Company, then known as Auto Swap, U.S.A., entered into a reverse merger with Water Chef, Inc., a Nevada corporation, which manufactured and marketed water coolers and filters.

PRODUCTS

In 2001 the Company decided to concentrate its efforts on the further development, manufacturing and marketing of the PureSafe Water Station (the "PureSafe"), because although Water Chef believed that its water dispensers and its wide variety of consumer oriented water filtration products met or exceeded the design, quality and performance of competitive products, market considerations were such as to limit the opportunities for profit and growth.

In 1998, searching for a "killer application," Water Chef management focused on the worldwide need for safe drinking water for populations who are not served by municipal water treatment facilities, or are served by municipal systems that have malfunctioned because of improper maintenance or faulty design. The result of that activity is the PureSafe Water Station, a turn-key unit that converts "gray," or bathing grade, water into EPA grade drinking water. The PureSafe eliminates all living pathogens that pollute non-processed water - bacteria, cysts, viruses, parasites, etc. - at an affordable cost for the emerging economies of the world.

The PureSafe was tested by H2M Labs, Inc. which has been approved by Nassau and Suffolk counties in New York to perform drinking water testing for the various municipalities in those counties. The specific test performed was a total and fecal coliform bacteria test, wherein the source water storage tank which feeds the PureSafe was tested for the presence of total and fecal coliform bacteria. The source water tank was found to have 50 colonies of coliform bacteria present. The source water tank was then "spiked" with a three (3) liter concentration of laboratory grown and cultured bacteria and the storage tank was measured again with 80,000,000 colonies of bacteria detected. After being processed through the PureSafe system, the water was tested again, and "FEWER THAN 2 COLONIES" were detected. In addition to the laboratory test conducted for Water Chef by H2M Labs, the available scientific literature, in industry journals such as Water Technology and Water Conditioning and Purification International, supports the statement that an ozone system such as the one utilized in the PureSafe effectively eliminates all living pathogens. Ozone was first used in municipal water treatment in Nice, France in 1904, and then in the Jerome Park Reservoir in the Bronx, New York in 1906.

The PureSafe is a self-contained, six stage water purification center. It is housed in the equivalent of a small storage container - approximately four feet wide, seven feet long, and six and one-half feet high. The unit weighs approximately eleven hundred pounds (without water) and has been configured for portability, durability, and easy access to its essentially off-the-shelf components. It is constructed with weather and UV resistant fiberglass, aluminum and steel, and is equipped with internal and external lighting.

The core version of the PureSafe can purify and dispense up to 15,000 gallons of

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water per day for an all-inclusive cost (labor, power, amortization of the capital cost, replacement filters, cartridges and media) of approximately one-half cent per gallon. The process wastes very little water, producing approximately one gallon of pure drinking water for every gallon processed. The unit can be moved with a single fork-lift and is transportable by truck or helicopter. Operating the PureSafe is simple and straightforward. Due to its turn-key design, minimum wage personnel can be trained to operate the unit. A system of fail-safes is built into the operation, and aside from easily installable spares such as filters and cartridges, a maintenance and oversight program established by Water Chef should maintain the operating efficiencies built into the system. Water Chef warrants each unit for a period of one year so long as the consumer adheres to required maintenance protocols, using Water Chef supplied parts, as prescribed in the maintenance manual. The Company also offers

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PRODUCTS (continued)

larger stand-alone versions of the PureSafe to provide pure water in quantities up to 20,000 gallons per hour. To date, there have been no warranty claims for the PureSafe product operating in the field.

While each unit is configured to respond to the particular water quality of a particular site, such as arsenic removal, seawater desalination, oil separation, etc., the typical unit contains the following components:

- a. Inlet connection with macro-filter - designed to strain the input water, removes large particulates and directs water into the system
- b. Inlet pump - self-priming pump which maintains water pressure at minimum 40 p.s.i. throughout the system
- c. Pre-depth media filter - a multi-media mixed bed to remove pollutants. Pressure gauges mounted on the exterior front panel of the unit allow for visible monitoring of system performance.
- d. Ozone generator - provides a rich ozone source that effectively kills all living pathogens such as bacteria, viruses, cysts, parasites, etc. Unused ozone reverts back to oxygen and produces no harmful byproducts.
- e. Ozone mixing tank - Water Chef's proprietary process for effectively mixing the ozone into the water and maintaining the required contact time to ensure oxidation of contaminants.
- f. Process pump - provides optimal operation of the ozone processing.
- g. Post-depth media filter - another, different, multi-media mixed bed designed to filter out oxidized or precipitated pollutants and contaminants after the ozone treatment. Effectively removes metals, organics and inorganics. Pressure gauges on the front panel indicate the need for backwashing to maintain optimal performance.
- h. Ultraviolet treatment - provided by a UV lamp as a redundant sterilizer step to eliminate any surviving pathogens or micro-organisms. The UV lamp is tuned to a frequency which also converts O₃ (ozone) back to O₂ (oxygen).
- i. KDF filter - an ion exchange media containing a proprietary blend of copper, zinc and other alloys, effectively absorbs chlorine and biological, inorganic and metallic contaminants.

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j. Carbon filter - prevents bacteria re-growth while removing inorganic compounds and improves water taste and removes odor. The carbon filter also acts as a redundant ozone destruct mechanism.

k. Mixer - sends ozone treated water to the bottle washing stations.

l. Bottle washing stations - incorporated on the outside front of the unit for easy access in order to effectively clean bottles used to carry water treated at the site.

m. Dispensing stations - four individual dispensing lines, each with flow adjusting valves to help regulate a smooth, steady flow of water into clean bottles.

MANUFACTURING

In 2000, the Company entered into a subcontracting agreement with Davis Aircraft Products Inc, ("Davis") for the manufacture of the PureSafe. Based upon the experience and the resources of Davis, Water Chef's management believes that Davis can provide the production and manufacturing support services necessary to supply Water Chef's requirements over the foreseeable future at a price, and with the quality and performance standards necessary to meet, or exceed, the needs of the markets that the Company expects to serve. In addition, Davis supervises much of the Company's research and development activities.

RAW MATERIALS

The PureSafe has been designed to use, for the most part, readily available off-the-shelf components, sub-systems and equipment. Inasmuch as each of the components and sub-systems are available from multiple vendors, the Company does not believe that obtaining these for its sub-contractor, for itself, or for others if it chooses to manufacture elsewhere, will be a problem.

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COMPETITION

Water Chef's modular, turn-key PureSafe Water Station directly addresses the drinking water needs of those environs which do not today, and are unlikely to enjoy access to municipally treated water. The Company has produced a turnkey solution that produces pure water to meet U.S. EPA drinking water standards. This is a far different market than that addressed by the segment of the industry which has concentrated on the multi-billion dollar municipal water treatment sector, or the equally large residential sector. The municipal solution requires significant investment for infrastructure development (building plants and laying miles of distribution pipes), and products for residential markets do not offer the performance or features to meet the needs of the underdeveloped nations of the world.

Management does recognize that its potential competitors have far more resources, and that being first to the marketplace is no assurance of success. It must be assumed that others are working on systems that, if successfully brought to market, could seriously impact the viability of the Company.

The Company currently has contracts to sell PureSafe units in Laos and Ecuador. In addition, the Company is actively marketing its products to potential customers in Bangladesh, China, El Salvador, Egypt and Honduras, and to agencies and departments of the U.S. Government.

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MARKETING

The potential market for the PureSafe is substantial and is both worldwide and domestic. According to studies performed by the World Health Organization (WHO) and the United Nations, major parts of Africa, the Middle East, Southeast Asia, the Indian sub-continent, Latin and South America, the Caribbean, and much of Eastern Europe is in need of adequate supplies of pure water. Parts of Florida, Georgia, and other regions in the United States have also reported fresh water deficits. In part, solving this problem has been a question of appropriate technology. Secondly, but just as important, in a vast part of the world is the need to secure third party financing so that the local populace can enjoy the benefits of clean water.

Water Chef believes that it has demonstrated that it possesses the technology. The Company also believes that financing is available for third world economies from a variety of sources. The challenge for the Company, a virtual unknown in the industry and with limited capital, is in getting its message in front of decision makers. To this end, Water Chef has enlisted the aid of some of the world's most outstanding experts in water purification, especially as it relates to the needs of underdeveloped countries.

The Company's Scientific Advisory Board is chaired by Dr. Ronald Hart, former Director of The National Center for Toxicological Research and a U.S. Food and Drug Administration "Distinguished Scientist in Residence." The Board also includes Dr. Mohamed M. Salem, Professor of Occupational and Environmental Medicine, Cairo University; Dr. Richard Wilson, Mallinckrodt Research Professor of Physics, Harvard University; Dr. Mostafa K. Tolba, former Under-Secretary-General of the United Nations and Director of the U.N.'s Environmental Program; and Lord John Gilbert, former Minister of State for Defense for the United Kingdom under three Prime Ministers and Secretary/Treasurer of the Tri-Lateral Commission.

Not only have the members of the Scientific Advisory Board provided valuable input and guidance to the Company with respect to system design, technological input, remediation approaches and a great deal of information relative to the unique water problems facing many areas of the world, but they have also been active in introducing Water Chef to commercial opportunities

During 2004, Water Chef established a relationship with the International Multiracial Shared Cultural Organization (IMSCO), an NGO (non-governmental organization) specialized with the Economic and Social Council of the United Nations. As a result of this relationship Water Chef has received United Nations certification for its pure water humanitarian projects in Honduras and Bangladesh, and became eligible to apply for third party funding of these projects. As of year-end 2004, the Company has submitted these projects for funding approval, but has received no assurance of funding.

With the recent funding of the Homeland Security Department budget, and a renewed focus on preparedness in the event of possible future terrorist attacks in the United States, programs have been initiated to ensure the protection and preservation of our water resources. Water Chef has been in discussion with political and government contacts to explore the applications for the PureSafe as a back-up drinking water system in case of damage to municipal systems. The Company has also initiated contact with senior government personnel to explore the use of our technology to safeguard water supplies at U.S. installations overseas.

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PATENTS

The Company filed for patent protection on its PureSafe Water Station in October of 1998 and received formal notification that the patent had been issued on February 19, 2002. The Company feels that this patent upholds its claims that the PureSafe system is a unique product. In addition to its U.S. patent, the Company has filed for patent protection in the countries of the European Union, and in Canada, Mexico, China, Hong Kong, Korea and Japan. The patent application for the European Union (01-126 980.0) was filed on November 13, 2001; Canadian Application No. 2,362,107 was filed on November 3, 2001; Mexican Application No. PA/a/2001/12042 was filed on November 23, 2001; the Chinese Application No. 01136187.5 was filed on November 21, 2001, and was found to be in compliance on June 20, 2003; the Hong Kong Application No. 03107837.9 was filed on October 3, 2003; and the Korean Patent Application No. 10-2001-0070453 was filed on November 20, 2001. Each of the patent applications has been accepted, Requests for Examination have been made, and the Company currently has patent protection in the requested venues.

The name PureSafe Water Station and the stylized water droplet mark have been trademarked in the United States.

Water Chef has also incorporated patented and proprietary technology in the PureSafe and is confident that it can protect this intellectual capital throughout the manufacturing and distribution cycle.

There can be no assurance that any application of the Company's technologies will not infringe patent or proprietary rights of others, or that licenses which might be required for the Company's processes or products would be available on favorable terms. Furthermore, there can be no assurance that challenges will not be made against the validity of the Company's patent, or that defenses instituted to protect against patent violation will be successful.

SEASONALITY

The Company does not expect the Pure Safe to be influenced by seasonality.

GOVERNMENT APPROVALS

The Company's marketing efforts to date have been directed to Central and South America, the Asian sub-continent, and the Middle East. No specific government approvals are required, except for the possibility that export licenses will be required in specific instances.

RESEARCH AND DEVELOPMENT

Research and development takes place at the Company's office. Testing, modeling, simulation and prototype manufacturing are outsourced with much of the ongoing development taking place at the Company's contract manufacturing facilities under the supervision of Davis Water Products. The Company estimates to date that the design, prototyping, development and marketing of the PureSafe Water Station has cost in excess of \$2 million.

INSURANCE

The Company maintains a \$1,000,000 umbrella policy, in addition to a \$2,000,000 general and product liability policy, which covers the manufacture and marketing of its products. The Company believes its insurance coverage to be adequate.

EMPLOYEES

As of December 31, 2005, the Company employed one executive officer and two administrative personnel in its headquarters.

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The Company believes there are a sufficient number of persons available at prevailing wage rates in or near our manufacturing locations that should expansion of its production require additional employees, they would be readily available. The Company has no collective bargaining agreement with any of its employees.

ITEM 2. DESCRIPTION OF PROPERTY

The Company presently has no owned or leased manufacturing facilities, nor does the Company have a plan to acquire its own manufacturing facility. The PureSafe Water Station is manufactured for the Company under a contract by Davis Water Products.

The Company maintains its principle place of business at 1007 Glen Cove Avenue, Suite 1, Glen Head, New York 11545. The company leases 1,100 square feet in such building at \$2,638 per month on a month-to-month basis.

To the extent possible, the Company intends to utilize leased space for its future needs.

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ITEM 3. LEGAL PROCEEDINGS

In May 2001, the Company entered into a distribution agreement with a company (the "Sub Distributor") based in Jordan. The Sub Distributor had agreed to purchase no fewer than 100 units of the Company's "Pure Safe Water Station" during 2001 and a minimum of 50 units in each of 2002 and 2003. To date, the Company has shipped 18 units to the Kingdom of Jordan, none of which have met the criteria for revenue recognition due to no reasonable assurance of collectibility. The Company has recorded the cost of the inventory shipped as a loss contingency of \$242,035 during the year ended December 31, 2001, since return of the items is uncertain. The Company has engaged legal counsel in Jordan, to pursue legal remedies and obtain payment for all units shipped.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

PRICE RANGE OF COMMON STOCK

The Company's common stock is traded on the Over-The-Counter Electronic Bulletin Board ("OTCBB") under the symbol WTER.OB. This market is categorized as being "thin" which means that there is generally a paucity of buyers and sellers as found in the more heavily traded Small Cap and NASDAQ markets. OTCBB stocks generally do not have the trading characteristics of more seasoned companies as they lack the market-makers that will make orderly markets as well as the buyers and sellers that give depth, liquidity and orderliness to those markets. In addition, the solicitation of orders and/or the recommendations for purchase of OTCBB stocks is restricted in many cases by the National Association of Securities Dealers and by individual brokerage firms as well.

The chart below sets forth the range of high and low bid prices for the

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Company's common stock based on high and low bid prices during each specified period as reported by the National Quotation Bureau, Inc. The prices reflect inter-dealer prices without retail mark-up, markdown, quotation or commission and do not necessarily represent actual transactions.

	HIGH	LOW
2004		
First Quarter	.36	.16
Second Quarter	.37	.14
Third Quarter	.34	.14
Fourth Quarter	.29	.14
2005		
First Quarter	.28	.14
Second Quarter	.21	.11
Third Quarter	.29	.13
Fourth Quarter	.17	.06

As of the close of business on December 31, 2005, there were 823 common stock holders of record.

DIVIDENDS

We have not paid any cash dividends on our common stock since our inception and do not anticipate paying any cash dividends in the foreseeable future. We plan to retain our earnings, if any, to provide funds for the expansion of our business. Subject to our obligations to the holders of our Series A and Series D Preferred shares, and to the holders of our Series F convertible preferred stock, the holders of our common stock are entitled to dividends when and if declared by our Board of Directors from legally available funds. Our Board of Directors will determine future dividend policy based upon conditions at that point, including our earnings and financial condition, capital requirements and other relevant factors.

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EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of December 31, 2005 with respect to our shares of Common Stock that may be issued under our existing equity compensation plans:

(a)	(b)
Number of securities to be issued upon exercise of outstanding options,	Weighted-average exercise price of outstanding options,

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Plan Category	warrants, and rights	warrants, and rights

Equity compensation plans approved by security holders	-	-
Equity compensation plans not approved by security Holders:		
Stock option plans (2)	6,000,000	\$0.25

(1) Excludes securities listed in column (a)

(2) Consists of 5,000,000 stock appreciation rights granted to David A. Conway that vest over 5 years and 1,000,000 stock appreciation rights granted to Marshall S. Sterman that vest over 2 years. These individuals were originally granted stock options in January 2004 that were later converted to stock appreciation rights. Mr. Sterman's stock appreciation rights expired on January 7, 2006.

RECENT ISSUANCES OF UNREGISTERED SECURITIES

Purchaser	Price per Share	Purchase Amount	Class	Date Purchased
Occidental Engineering Consultants	0.1420	Late Fee for Interest Payment 14,200	Common	10/19
Salvatore Lo Bue	0.0700	27,625	Common	11/18
Anthony Giambrone	0.0700	48,000	Common	11/18
Roger Borsett	0.0600	Commission 7,500	Common	11/18
The Resnick Druckman Group LLC	0.0500	Compensation for Accounting Services 6,625	Common	11/18
Salvatore Lo Bue	0.0700	24,335	Common	11/29
Simplified Employee Pension Plan FBO Laura A Fonseca	0.0750	35,000	Common	11/29
James K Tse	0.0650	25,000	Common	11/29
KML	0.0500	30,000	Common	12/19
Max Ollech	0.0500	50,000	Common	12/19
Raimond Irni	0.0500	Commission 7,500	Common	12/19

The Company issued these shares in reliance upon the exemption from registration afforded by Section 4(2) of the Securities Act of 1933 and Regulation D promulgated there under. These shares were offered to less than 35 "non-accredited" investors and were purchased for investment purposes with no

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view to resale.

Proceeds from the sales of these securities were used for general corporate purposes.

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ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

INTRODUCTION

DEVELOPMENT OF THE COMPANY

The Company was originally incorporated under Arizona law in 1985 and merged into a Delaware corporation in 1987. In 1993, the Company, then known as Auto Swap, U.S.A., entered into a reverse merger with Water Chef, Inc., a Nevada corporation that manufactured and marketed water coolers and filters.

The PureSafe has been designed by the Company to meet the needs of communities who either did not have access to municipal water treatment systems, or to those whose systems had been compromised, either by environmental factors or by faulty design or maintenance.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet debt nor did we have any transactions, arrangements, obligations (including contingent obligations) or other relationships with any unconsolidated entities or other persons that may have a material current or future effect on financial conditions, changes in financial conditions, result of operations, liquidity, capital expenditures, capital resources, or significant components of revenue or expenses.

RESULTS OF OPERATIONS

Sales for the years ended December 31, 2005 and 2004 were \$260,000 and \$56,290, respectively. During the year ended December 31, 2005, the Company recognized the sale of five PureSafe Water Station Systems. Four of these were purchased for use in Ecuador and the fifth system was purchased by a humanitarian buyer to be used as part of the tsunami relief effort in Sri Lanka. In addition, Water Chef received deposits totaling \$115,000 during 2005 for relief effort systems that will be shipped in 2006.

Cost of sales decreased from \$62,250 for the year ended December 31, 2004, to \$42,000 for the year ended December 31, 2005, a decrease of \$20,250, or 33%. An analysis of theew Roman" SIZE="2">

2,599

NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES

32,916

28,790

NON-INTEREST INCOME:

Wealth and asset management fees

1,225

1,255

Service charges on deposit accounts

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3,129

3,117

Other service charges and fees

1,201

1,048

Net realized and unrealized losses on securities for which fair value was elected

(216
)

(42
)

Mortgage banking

506

365

Bank owned life insurance

674

602

Other

986

841

7,505

7,186

Total other-than-temporary impairment losses on available-for-sale securities

(398
)

(1,923
)

Less portion of loss recognized in other comprehensive income

0

0

Net impairment losses recognized in earnings

(398
)

(1,923
)

Net realized gains on available-for-sale securities

158

691

Net impairment losses recognized in earnings and realized gains on available-for-sale securities

(240
)

(1,232
)

Total non-interest income

7,265

5,954

NON-INTEREST EXPENSES:

Salaries and benefits

12,842

11,689

Net occupancy expense of premises

3,378

3,204

FDIC insurance premiums

969

1,202

Amortization of intangibles

0

75

Other

7,553

7,434

Total non-interest expenses

24,742

23,604

INCOME BEFORE INCOME TAXES

15,439

11,140

INCOME TAX EXPENSE

4,204

2,750

NET INCOME

\$
11,235

\$
8,390

EARNINGS PER SHARE:

Basic

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\$
0.91

\$
0.83

Diluted

\$
0.91

\$
0.83

DIVIDENDS PER SHARE:

Cash dividends per share

\$
0.495

\$
0.495

See Notes to Consolidated Financial Statements

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

Dollars in thousands

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
NET INCOME	\$ 4,067	\$ 3,106	\$ 11,235	\$ 8,390
Other comprehensive income, net of tax:				
Change in fair value of interest rate swap agreements designated as cash flow hedges, net of tax of \$237 and \$33 for the three months ended September 30, 2011 and 2010, and \$279 and \$115 for the nine months ended September 30, 2011 and 2010	(440)	(61)	(519)	(213)
Net change in unrealized gains (losses) on securities available for sale:				
Unrealized losses on other-than-temporarily impaired securities available for sale:				
Unrealized losses arising during the period, net of tax of \$49 and \$36 for the three months ended September 30, 2011 and 2010, and \$17 and \$172 for the nine months ended September 30, 2011 and 2010	(91)	(66)	(31)	(320)
Reclassification adjustment for losses included in net income, net of tax of (\$287) for the three months ended September 30, 2010, and (\$139) and (\$673) for the nine months ended September 30, 2011 and 2010	0	534	259	1,250
	(91)	468	228	930
Unrealized gains on other securities available for sale:				
Unrealized gains arising during the period, net of tax of (\$3,441) and (\$3,315) for the three months ended September 30, 2011 and 2010, and (\$7,998) and (\$6,094) for the nine months ended September 30, 2011 and 2010	6,391	6,156	14,854	11,317
Reclassification adjustment for accumulated gains included in net income, net of tax of \$29 and \$41 for the three months ended ended September 30, 2011 and 2010, and \$55 and \$242 for the nine months ended September 30, 2011 and 2010	(55)	(77)	(103)	(449)
	6,336	6,079	14,751	10,868
Other comprehensive income	5,805	6,486	14,460	11,585
COMPREHENSIVE INCOME	\$ 9,872	\$ 9,592	\$ 25,695	\$ 19,975

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CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Dollars in thousands

	Nine months ended September 30,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 11,235	\$ 8,390
Adjustments to reconcile net income to net cash provided by operations:		
Provision for loan losses	2,673	2,599
Depreciation and amortization	1,539	1,533
Amortization, accretion and deferred loan fees and costs	1,898	1,588
Net impairment losses realized in earnings and gains on sales of available-for-sale securities	240	1,232
Net realized and unrealized losses on securities for which fair value was elected	216	42
Proceeds from sale of securities for which fair value was elected	170	0
Purchase of securities for which fair value was elected	(899)	0
Gain on sale of loans	(424)	(270)
Net gains on dispositions of premises and equipment and foreclosed assets	(102)	(101)
Proceeds from sale of loans	14,735	6,008
Origination of loans held for sale	(11,109)	(11,932)
Earnings on bank owned life insurance	(674)	(602)
Stock-based compensation expense	164	166
Contribution of treasury stock	90	0
Changes in:		
Accrued interest receivable and other assets	(2,347)	(2,602)
Accrued interest payable and other liabilities	4,966	(269)
NET CASH PROVIDED BY OPERATING ACTIVITIES	22,371	5,782
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in interest bearing time deposits with other banks	2,593	2,871
Proceeds from maturities, prepayments and calls of securities	75,791	86,330
Proceeds from sales of securities	43,763	51,507
Purchase of securities	(190,487)	(279,073)
Loan origination and payments, net	(42,318)	(36,251)
Purchase of bank owned life insurance	(5,000)	(2,500)
Redemption (purchase) of FHLB and other equity interests	(179)	181
Purchase of premises and equipment	(1,483)	(1,542)
Proceeds from the sale of premises and equipment and foreclosed assets	245	287
NET CASH USED IN INVESTING ACTIVITIES	(117,075)	(178,190)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in:		
Checking, money market and savings accounts	215,087	130,487
Certificates of deposit	(80,393)	27,309

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Proceeds from sale of treasury stock	922	923
Proceeds from exercise of stock options	0	69
Proceeds from stock offering, net of issuance costs	0	32,128
Cash dividends paid	(6,085)	(4,916)
Proceeds from long-term borrowings	350	20,000
Repayment of long-term borrowings	(95)	(36,085)
Net change in short-term borrowings	(31,338)	10,927
NET CASH PROVIDED BY FINANCING ACTIVITIES	98,448	180,842
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,744	8,434
CASH AND CASH EQUIVALENTS, Beginning	37,432	22,358
CASH AND CASH EQUIVALENTS, Ending	\$ 41,176	\$ 30,792
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 13,626	\$ 14,207
Income taxes	3,317	3,314
SUPPLEMENTAL NONCASH DISCLOSURES:		
Transfers to other real estate owned	93	333
Loans transferred from held for sale to held for investment	0	3,321
Grant of restricted stock awards from treasury stock	266	233

See Notes to Consolidated Financial Statements

Table of Contents**CNB FINANCIAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****BASIS OF PRESENTATION**

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

In the opinion of management of the registrant, the accompanying consolidated financial statements as of September 30, 2011 and for the three and nine month periods ended September 30, 2011 and 2010 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the periods presented. The financial performance reported for CNB Financial Corporation (the Corporation) for the three and nine month periods ended September 30, 2011 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Corporation s Annual Report on Form 10-K for the period ended December 31, 2010 (the 2010 Form 10-K). All dollar amounts are stated in thousands, except share data.

STOCK COMPENSATION

The Corporation has a stock incentive plan for key employees and independent directors. The stock incentive plan, which is administered by a committee of the Board of Directors, provides for aggregate grants of up to 500,000 shares of common stock in the form of nonqualified options or restricted stock. For key employees, the plan vesting is one-fourth of the granted options or restricted stock per year beginning one year after the grant date, with 100% vested on the fourth anniversary of the grant. For independent directors, the vesting schedule is one-third of the granted options per year beginning one year after the grant date, with 100% vested on the third anniversary of the grant.

At September 30, 2011, there was no unrecognized compensation cost related to nonvested stock options granted under this plan, and no stock options were granted during the three and nine month periods then ended.

Compensation expense for the restricted stock awards is recognized over the requisite service period noted above based on the fair value of the shares at the date of grant. Unearned restricted stock awards are recorded as a reduction of shareholders equity until earned. Compensation expense resulting from these restricted stock awards was \$62 and \$164 for the three and nine months ended September 30, 2011, and \$44 and \$166 for the three and nine months ended September 30, 2010. As of September 30, 2011, there was \$447 of total unrecognized compensation cost related to unvested restricted stock awards.

A summary of changes in unvested restricted stock awards for the three months ended September 30, 2011 follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	40,281	\$ 15.12
Granted		
Vested	(1,319)	14.81
Forfeited		
Nonvested at end of period	38,962	\$ 15.12

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A summary of changes in unvested restricted stock awards for the nine months ended September 30, 2011 follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	31,398	\$ 15.10
Granted	17,900	14.88
Vested	(9,148)	14.59
Forfeited	(1,188)	14.85
Nonvested at end of period	38,962	\$ 15.12

FAIR VALUE**Fair Value Option**

Management elected to adopt the fair value option for its investment in certain equity securities in order to provide financial statement users with greater visibility into the Corporation's financial instruments that do not have a defined maturity date.

Fair value changes attributable to unrealized losses that were included in earnings for the three and nine months ended September 30, 2011 were (\$313) and (\$226), respectively. Fair value changes attributable to unrealized gains that were included in earnings for the three and nine month ended September 30, 2010 were \$23 and \$26. Realized gains on the sale of securities for which the fair value option was elected were \$0 and \$10 during the three and nine months ended September 30, 2011. Realized losses on the sale of securities for which the fair value option was elected were (\$8) and (\$68) during the three and nine months ended September 30, 2010.

Dividend income is recorded based on cash dividends and comprises the Dividends line item in the accompanying consolidated statement of income. Dividend income was \$8 and \$23 for the three and nine months ended September 30, 2011 and \$6 and \$20 for the three and nine months ended September 30, 2010.

Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy has also been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following three levels of inputs are used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of most trading securities and securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The fair values of certain residential mortgage-backed securities, one corporate bond, and one bond issued by a government sponsored entity classified as available for sale have been determined by using Level 3 inputs. The Corporation has engaged a valuation expert to price these securities using a proprietary model, which incorporates assumptions that market participants would use in pricing the securities, including bid/ask spreads and liquidity and credit premiums.

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Trust preferred securities which are issued by financial institutions and insurance companies are priced using Level 3 inputs. The decline in the level of observable inputs and market activity in this class of investments by the measurement date has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, vary widely, and the once-active market has become comparatively inactive. The Corporation engaged a third party consultant who has developed a model for pricing these securities. Information such as historical and current performance of the underlying collateral, deferral and default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a market participant, and financial trend analysis with respect to the individual issuing financial institutions and insurance companies are utilized in determining individual security valuations. Due to the current market conditions as well as the limited trading activity of these securities, the market value of the securities is highly sensitive to assumption changes and market volatility. The Corporation's derivative instrument is an interest rate swap that is similar to those that trade in liquid markets. As such, significant fair value inputs can generally be verified and do not typically involve significant management judgments (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Assets and liabilities measured at fair value on a recurring basis are as follows at September 30, 2011 and December 31, 2010:

Description	Total	Fair Value Measurements at September 30, 2011 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities Available For Sale:				
U.S. Treasury	\$ 8,162	\$	\$ 8,162	\$
U.S. Government sponsored entities	97,912	6,000	91,912	
States and political subdivisions	142,044	7,131	134,913	
Residential mortgage and asset backed	280,428	21,056	259,372	
Commercial mortgage and asset backed	2,050		2,050	
Corporate notes and bonds	14,541	1,000	11,681	1,860
Pooled trust preferred	1,227			1,227
Pooled SBA	44,432	44,432		
Other securities	1,709	1,709		
Total Securities Available For Sale	\$ 592,505	\$ 81,328	\$ 508,090	\$ 3,087
Trading Securities:				
Equity securities financial services	\$ 621	\$ 621	\$	\$
Equity securities industrials	323	323		
International mutual funds	257	257		
Equity securities health care	186	186		
Equity securities utilities	171	171		
Certificates of deposit	156	156		
Corporate notes and bonds	150		150	
Large cap growth mutual funds	138	138		
U.S. Government sponsored entities	129		129	
Money market mutual funds	111	111		
Real estate investment trust mutual funds	105	105		
Equity securities energy	103	103		
Large cap value mutual funds	97	97		
Equity securities consumer staples	62	62		
Equity securities consumer discretionary	49	49		
Mid cap mutual funds	35	35		

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Small cap mutual funds	33	33		
Equity securities materials	30	30		
Total Trading Securities	\$ 2,756	\$ 2,477	\$ 279	\$

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Description	Total	Fair Value Measurements at September 30, 2011 Using Quoted Prices in Active Markets for		
		Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities,				
Interest rate swaps	\$ (1,665)	\$	\$ (1,665)	\$

Description	Total	Fair Value Measurements at December 31, 2010 Using Quoted Prices in Active Markets for Significant Other Unobservable		
		Identical Assets (Level 1)	Observable Inputs (Level 2)	Inputs (Level 3)
Assets:				
Securities Available For Sale:				
U.S. Treasury	\$ 8,205	\$	\$ 8,205	\$
U.S. Government sponsored entities	105,941	2,000	101,941	2,000
States and political subdivisions	116,411	4,750	111,661	
Residential mortgage and asset backed	222,419	20,405	199,745	2,269
Corporate notes and bonds	10,751		9,511	1,240
Pooled trust preferred	1,292			1,292
Pooled SBA	33,962	28,489	5,473	
Other securities	1,696	1,696		
Total Securities Available For Sale	\$ 500,677	\$ 57,340	\$ 436,536	\$ 6,801

Trading Securities:

Equity securities financial services	\$ 523	\$ 523	\$	\$
International mutual funds	430	430		
Large cap value mutual funds	247	247		
Certificates of deposit	208	208		
Equity securities health care	151	151		
U.S. Government sponsored entities	147		147	
Large cap growth mutual funds	139	139		
Equity securities energy	119	119		
Equity securities industrials	98	98		
Corporate notes and bonds	96		96	
Money market mutual funds	75	75		
Equity securities utilities	61	61		
Small cap mutual funds	29	29		
Mid cap mutual funds	28	28		
Total Trading Securities	\$ 2,351	\$ 2,108	\$ 243	\$

Liabilities,

Interest rate swap	\$ (867)	\$	\$ (867)	\$
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The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended September 30, 2011:

Residential mortgage and	Corporate notes and	Pooled trust
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	asset backed	bonds	preferred
Balance, July 1, 2011	\$ 3,988	\$ 1,860	\$ 1,362
Transfers out of Level 3 (a)(b)	(3,988)		
Total gains or losses (realized/unrealized):			
Included in other comprehensive income			(130)
Purchases, issuances, sales, and settlements:			
Settlements			(5)
Balance, September 30, 2011	\$	\$ 1,860	\$ 1,227

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- (a) Transferred from Level 3 to Level 2 since observable market data became available to value the security.
 (b) The Corporation's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer.

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2011:

	Residential mortgage and asset backed	Corporate notes and bonds	U.S. Gov't Sponsored Entities	Pooled trust preferred
Balance, January 1, 2011	\$ 2,269	\$ 1,240	\$ 2,000	\$ 1,292
Transfers out of Level 3 (a)(b)	(3,988)		(2,000)	
Total gains or losses (realized/unrealized):				
Included in earnings				(398)
Included in other comprehensive income		620		338
Purchases, issuances, sales, and settlements:				
Purchases	1,917			
Settlements	(198)			(5)
Balance, September 30, 2011	\$	\$ 1,860	\$	\$ 1,227

- (a) Transferred from Level 3 to Level 2 since observable market data became available to value the security.
 (b) The Corporation's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer.

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2010:

	Three months ended September 30, 2010			Nine months ended September 30, 2010		
	Residential mortgage and asset backed	Corporate notes and bonds	Pooled trust preferred	Residential mortgage and asset backed	Corporate notes and bonds	Pooled trust preferred
Beginning balance	\$ 415	\$ 1,300	\$ 1,524	\$ 503	\$	\$ 1,909
Transfers into Level 3 (a) (b)					1,040	
Transfers out of Level 3						
Total gains or losses (realized/unrealized):						
Included in earnings			(821)			(1,923)
Included in other comprehensive income		(20)	709		240	1,436
Purchases, issuances, sales, and settlements:						
Sales						
Settlements	(52)			(140)		(10)
Ending balance	\$ 363	\$ 1,280	\$ 1,412	\$ 363	\$ 1,280	\$ 1,412

- (a) Transferred from Level 2 to Level 3 because of lack of observable market data due to decrease in market activity for this security.

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(b) The Corporation's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer.

The unrealized losses reported in earnings for the three and nine months ended September 30, 2011 and 2010 for Level 3 assets that are still held at the balance sheet date relate to pooled trust preferred securities deemed to be other-than-temporarily impaired.

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During the three months ended September 30, 2011 and 2010, the following available for sale securities reported as Level 1 securities as of the beginning of the period were transferred to the Level 2 category:

	2011	2010
U.S. Government sponsored entities	\$	\$ 16,502
States and political subdivisions		11,085
Residential mortgage and asset backed		25,636
Total	\$	\$ 53,223

During the nine months ended September 30, 2011 and 2010, the following available for sale securities reported as Level 1 securities as of the beginning of the period were transferred to the Level 2 category:

	2011	2010
U.S. Government sponsored entities	\$ 2,000	\$ 18,643
States and political subdivisions	4,750	3,273
Residential mortgage and asset backed	20,405	5,625
Total	\$ 27,155	\$ 27,541

These securities were transferred from the Level 1 category to the Level 2 category since there were no longer quoted prices for identical assets in active markets that the Corporation had the ability to access.

During the nine months ended September 30, 2011, two pooled Small Business Administration (SBA) securities that were classified as Level 2 securities at December 31, 2010 were transferred to the Level 1 category. The fair value on the date of transfer was \$3,437. There were no transfers of securities from the Level 2 category to the Level 1 category during the three months ended September 30, 2011. During the three months ended September 30, 2010, one pooled SBA security that was classified as a Level 2 security at June 30, 2010 was transferred to the Level 1 category. The fair value on the date of transfer was \$884. During the nine months ended September 30, 2010, two pooled SBA securities that were classified as Level 2 securities at December 31, 2009 were transferred to the Level 1 category. The fair value on the date of transfer was \$1,798. These securities were transferred since the Corporation was able to access a quoted price for identical assets in an active market.

Assets and liabilities measured at fair value on a non-recurring basis are as follows at September 30, 2011 and December 31, 2010:

Description	Fair Value Measurements at September 30, 2011 Using			
	Total	Quoted Prices in		
		Active	Significant Other	Significant
		Markets for	Observable	Unobservable
	Identical Assets	Inputs	Inputs	
	(Level 1)	(Level 2)	(Level 3)	
Assets:				
Impaired loans:				
Commercial mortgages	\$ 13,822	\$	\$	\$ 13,822
Commercial, industrial, and agricultural	2,426			2,426
Residential real estate	122			122

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Description	Fair Value Measurements at December 31, 2010 Using			
	Total	Quoted Prices in		
		Active		
		Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans:				
Commercial mortgages	\$ 9,721	\$	\$	\$ 9,721
Commercial, industrial, and agricultural	2,474			2,474
Residential real estate	166			166

Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans, had a principal balance of \$18,010 with a valuation allowance of \$1,640 as of September 30, 2011, resulting in an additional provision for loan losses of \$530 and \$782 for the three and nine months then ended. Impaired loans had a principal balance of \$13,324 with a valuation allowance of \$963 as of December 31, 2010, resulting in an additional provision for loan losses of \$951 for the year then ended.

Fair Value of Financial Instruments

Carrying amount is the estimated fair value for cash and cash equivalents, accrued interest receivable and payable, demand deposits, other borrowings, and variable rate loans, deposits or borrowings that reprice frequently and fully. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of loans held for sale is based on market quotes. Fair value of debt is based on current rates for similar financing. It is not practical to determine the fair value of Federal Home Loan Bank stock and other equity interests due to restrictions placed on the transferability of these instruments. The fair value of off balance sheet items is based on the current fees or cost that would be charged to enter into or terminate such arrangements. The fair value of off balance sheet items is not material.

While estimates of fair value are based on management's judgment of the most appropriate factors as of the balance sheet date, there is no assurance that the estimated fair values would have been realized if the assets had been disposed of or the liabilities settled at that date, since market values may differ depending on various circumstances. The estimated fair values would also not apply to subsequent dates.

In addition, other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the disclosures. Also, non-financial assets such as, among other things, the estimated earnings power of core deposits, the earnings potential of trust accounts, the trained workforce, and customer goodwill, which typically are not recognized on the balance sheet may have value but are not included in the fair value disclosures.

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The following table presents the carrying amount and fair value of financial instruments at September 30, 2011 and December 31, 2010:

	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
ASSETS				
Cash and cash equivalents	\$ 41,176	\$ 41,176	\$ 37,432	\$ 37,432
Interest bearing time deposits with other banks	224	229	2,817	2,719
Securities available for sale	592,505	592,505	500,677	500,677
Trading securities	2,756	2,756	2,351	2,351
Loans held for sale	1,049	1,070	4,451	4,518
Net loans	823,414	844,580	783,742	807,972
FHLB and other equity interests	6,594	N/A	6,415	N/A
Accrued interest receivable	6,476	6,476	5,867	5,867
LIABILITIES				
Deposits	\$ (1,297,562)	\$ (1,301,803)	\$ (1,162,868)	\$ (1,167,071)
FHLB, Treasury, tax and loan, and other borrowings	(75,424)	(83,771)	(106,507)	(109,963)
Subordinated debentures	(20,620)	(10,746)	(20,620)	(10,660)
Interest rate swaps	(1,665)	(1,665)	(867)	(867)
Accrued interest payable	(1,355)	(1,355)	(1,666)	(1,666)

SECURITIES

Securities available for sale at September 30, 2011 and December 31, 2010 were as follows:

	Amortized Cost	September 30, 2011		Fair Value	Amortized Cost	December 31, 2010		Fair Value
		Unrealized Gains	Unrealized Losses			Unrealized Gains	Unrealized Losses	
U.S. Treasury	\$ 8,078	\$ 84	\$	\$ 8,162	\$ 8,139	\$ 66	\$ -	\$ 8,205
U.S. Gov t sponsored entities	92,635	5,282	(5)	97,912	104,328	2,016	(403)	105,941
State & political subdivisions	133,580	8,464		142,044	117,928	1,011	(2,528)	116,411
Residential mortgage & asset backed	272,196	8,427	(195)	280,428	221,304	2,364	(1,249)	222,419
Commercial mortgage & asset backed	2,079		(29)	2,050				
Corporate notes & bonds	17,354		(2,813)	14,541	14,347		(3,596)	10,751
Pooled trust preferred	1,787		(560)	1,227	2,190	12	(910)	1,292
Pooled SBA	43,102	1,330		44,432	33,788	266	(92)	33,962
Other securities	1,670	39		1,709	1,670	26		1,696
Total	\$ 572,481	\$ 23,626	\$ (3,602)	\$ 592,505	\$ 503,694	\$ 5,761	\$ (8,778)	\$ 500,677

At September 30, 2011, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

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Trading securities accounted for under the fair value option at September 30, 2011 and December 31, 2010 are as follows:

	September 30, 2011	December 31, 2010
Corporate equity securities	\$ 1,545	\$ 952
International mutual funds	257	430
Certificates of deposit	156	208
Corporate notes and bonds	150	96
Large cap growth mutual funds	138	139
U.S. Government sponsored entities	129	147
Money market mutual funds	111	75
Real estate investment trust mutual funds	105	
Large cap value mutual funds	97	247
Mid cap mutual funds	35	28
Small cap mutual funds	33	29
 Total	 \$ 2,756	 \$ 2,351

Securities with unrealized losses at September 30, 2011 and December 31, 2010, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

September 30, 2011

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury	\$	\$	\$	\$	\$	\$
U.S. Gov t sponsored entities	1,734	(5)			1,734	(5)
State & political subdivisions						
Residential mortgage & asset backed	25,154	(138)	5,567	(57)	30,721	(195)
Commercial mortgage & asset backed	2,050	(29)			2,050	(29)
Corporate notes & bonds	995	(1)	10,547	(2,812)	11,542	(2,813)
Pooled trust preferred			240	(560)	240	(560)
Pooled SBA						
Other securities						
	\$ 29,933	\$ (173)	\$ 16,354	\$ (3,429)	\$ 46,287	\$ (3,602)

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2010						
U.S. Treasury	\$	\$	\$	\$	\$	\$
U.S. Gov t sponsored entities	11,077	(403)			11,077	(403)
State & political subdivisions	61,312	(2,440)	3,904	(88)	65,216	(2,528)
Residential mortgage & asset backed	69,576	(1,228)	5,770	(21)	75,346	(1,249)
Corporate notes & bonds	992	(3)	9,770	(3,593)	10,762	(3,596)
Pooled trust preferred			288	(910)	288	(910)
Pooled SBA	12,147	(92)			12,147	(92)
Other securities						

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\$ 155,104 \$ (4,166) \$ 19,732 \$ (4,612) \$ 174,836 \$ (8,778)

The Corporation evaluates securities for other-than-temporary impairment on a quarterly basis, or more frequently when economic or market conditions warrant such an evaluation.

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At September 30, 2011, management evaluated the structured pooled trust preferred securities for other-than-temporary impairment by estimating the cash flows expected to be received from each security within the collateral pool, taking into account future estimated levels of deferrals and defaults by the underlying issuers, and discounting those cash flows at the appropriate accounting yield. Management also assumed that all issuers in deferral will default prior to their next payment date. Trust preferred collateral is deeply subordinated within issuers' capital structures, so large recoveries are unlikely. Accordingly, management assumed 10% recoveries on bank collateral and none on collateral issued by other companies. Due to the current crisis in the U.S. economy, management also added a baseline default rate of 2% annually for the next two years to our default projections for specific issuers. This percentage represents the peak, post-war bank default rate that occurred at the height of the savings and loan crisis, which we believe is an accurate proxy for the current environment. Management expects that credit markets will begin to normalize and that banks with the financial strength to survive will default at a .36% average annual rate, which represents Moody's idealized default probability for BBB corporate credits, and is in line with historical bank failure rates. In addition, management expects prepayments to occur at a rate of approximately 5% over a five year period, with the exception of certain large institutions that are expected to begin calling their collateral in 2011 and 2012 as a result of the elimination of the Tier I capital treatment of trust preferred securities for institutions with greater than \$15 billion in assets beginning in 2013.

Using this methodology, five of the Corporation's structured pooled trust preferred securities are deemed to be other-than-temporarily impaired. An impairment loss for the entire cost basis of two of these securities was recognized in earnings prior to 2010, and impairment losses for the remaining securities were recognized in earnings during 2011, as disclosed in the table below. The Corporation separated the other-than-temporary impairment related to these structured pooled trust preferred securities into (a) the amount of the total impairment related to credit loss, which is recognized in the income statement, and (b) the amount of the total impairment related to all other factors, which is recognized in other comprehensive income. The Corporation measured the credit loss component of other-than-temporary impairment based on the difference between the cost basis and the present value of cash flows expected to be collected.

The following table provides detailed information related to the Corporation's structured pooled trust preferred securities as of and for the three and nine months ended September 30, 2011:

	Adjusted Amortized Cost	Unrealized Gain (Loss)	Fair Value	Credit Losses Realized in Earnings Three Months Ended September 30, 2011	Credit Losses Realized in Earnings Nine Months Ended September 30, 2011
ALESCO Preferred Funding V, Ltd.	\$ 800	\$ (560)	\$ 240	\$	\$
ALESCO Preferred Funding XII, Ltd.					280
ALESCO Preferred Funding XVII, Ltd.					
Preferred Term Securities XVI, Ltd.					118
US Capital Funding VI, Ltd.					
MM Community Funding II, Ltd.	987		987		
Total	\$ 1,787	\$ (560)	\$ 1,227	\$	\$ 398

A roll-forward of the other-than-temporary impairment amount related to credit losses for the three months ended September 30, 2011 is as follows:

Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period	\$ 4,054
Additional credit loss for which other-than-temporary impairment was not previously recognized	
Additional credit loss for which other-than-temporary impairment was previously recognized	

Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period	\$ 4,054
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A roll-forward of the other-than-temporary impairment amount related to credit losses for the nine months ended September 30, 2011 is as follows:

Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period	\$ 3,656
Additional credit loss for which other-than-temporary impairment was not previously recognized	
Additional credit loss for which other-than-temporary impairment was previously recognized	398

Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period	\$ 4,054
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A roll-forward of the other-than-temporary impairment amount related to credit losses for the three months ended September 30, 2010 is as follows:

Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period	\$ 2,517
Additional credit loss for which other-than-temporary impairment was not previously recognized	821
Additional credit loss for which other-than-temporary impairment was not previously recognized	

Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period	\$ 3,338
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A roll-forward of the other-than-temporary impairment amount related to credit losses for the nine months ended September 30, 2010 is as follows:

Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period	\$ 1,415
Additional credit loss for which other-than-temporary impairment was not previously recognized	759
Additional credit loss for which other-than-temporary impairment was previously recognized	1,164

Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period	\$ 3,338
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At September 30, 2011, approximately 16% of the total unrealized losses relate to structured pooled trust preferred securities, primarily from issuers in the financial services industry, which are not currently trading in an active, open market with readily observable prices. As a result, these securities were classified within Level 3 of the valuation hierarchy. The fair values of these securities have been calculated using a discounted cash flow model and market liquidity premium. With the current market conditions, the assumptions used to determine the fair value of Level 3 securities has greater subjectivity due to the lack of observable market transactions. The fair values of these securities have declined due to the fact that subsequent offerings of similar securities pay a higher market rate of return. This higher rate of return reflects the increased credit and liquidity risks in the marketplace. Except as described above, based on management's evaluation of the structured pooled trust preferred securities, the present value of the projected cash flows is sufficient for full repayment of the amortized cost of the securities and, therefore, it is believed that the decline in fair value is temporary due to current market conditions. However, without recovery of these securities, other-than-temporary impairments may occur in future periods.

For all of the securities that comprise corporate notes and bonds and states and political subdivisions, management monitors publicly available financial information such as filings with the SEC in order to evaluate the securities for other-than-temporary impairment. For financial institution issuers, management also monitors information from quarterly call report filings that are used to generate Uniform Bank Performance

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Reports. When reviewing this information, management considers the financial condition and near term prospects of the issuer and whether downgrades by bond rating agencies have occurred. Management also considers the length of time and extent to which fair value has been less than cost and the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

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As of September 30, 2011 and December 31, 2010, management concluded that the previously mentioned securities were not other-than-temporarily impaired for the following reasons:

there is no indication of any significant deterioration of the creditworthiness of the institutions that issued the securities;

the unrealized losses are predominantly attributable to liquidity disruptions within the credit markets and the generally stressed condition of the financial services industry; and

all contractual interest payments on the securities have been received as scheduled, and no information has come to management's attention through the processes previously described which would lead to a conclusion that future contractual payments will not be timely received.

The Corporation does not intend to sell and it is not more likely than not that it will be required to sell the securities in an unrealized loss position before recovery of its amortized cost basis.

Information pertaining to security sales is as follows:

	Proceeds	Gross Gains	Gross Losses
Three months ended September 30, 2011	\$ 20,153	\$ 109	\$ (25)
Nine months ended September 30, 2011	43,763	255	(97)
Three months ended September 30, 2010	13,442	121	(3)
Nine months ended September 30, 2010	51,507	708	(17)

The following is a schedule of the contractual maturity of securities available for sale, excluding equity securities, at September 30, 2011 and December 31, 2010:

	September 30, 2011		December 31, 2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
1 year or less	\$ 20,453	\$ 20,586	\$ 30,210	\$ 30,184
1 year - 5 years	70,809	72,944	54,476	55,030
5 years - 10 years	104,510	112,597	105,057	105,145
After 10 years	100,764	102,191	90,977	86,203
	296,536	308,318	280,720	276,562
Residential mortgage & asset backed securities	272,196	280,428	221,304	222,419
Commercial mortgage & asset backed securities	2,079	2,050		
Total debt securities	\$ 570,811	\$ 590,796	\$ 502,024	\$ 498,981

Mortgage and asset backed securities are not due at a single date; periodic payments are received based on the payment patterns of the underlying collateral.

On September 30, 2011 and December 31, 2010, securities carried at \$247,622 and \$127,364, respectively, were pledged to secure public deposits and for other purposes as provided by law.

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LOANS

Total net loans at September 30, 2011 and December 31, 2010 are summarized as follows:

	September 30, 2011	December 31, 2010
Commercial, industrial, and agricultural	\$ 247,628	\$ 257,491
Commercial mortgages	238,965	212,878
Residential real estate	293,883	266,604
Consumer	54,766	53,202
Credit cards	2,968	2,870
Overdrafts	293	3,964
Less: unearned discount	(2,837)	(2,447)
allowance for loan losses	(12,252)	(10,820)
Loans, net	\$ 823,414	\$ 783,742

At September 30, 2011 and December 31, 2010, net unamortized loan costs and fees of (\$49) and (\$167), respectively, have been included in the carrying value of loans.

The Corporation's outstanding loans and related unfunded commitments are primarily concentrated within Central and Western Pennsylvania. The Bank attempts to limit concentrations within specific industries by utilizing dollar limitations to single industries or customers, and by entering into participation agreements with third parties. Collateral requirements are established based on management's assessment of the customer.

Transactions in the allowance for loan losses for the three months ended September 30, 2011 were as follows:

	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses, July 1, 2011	\$ 3,770	\$ 4,399	\$ 1,900	\$ 1,400	\$ 104	\$ 142	\$ 11,715
Charge-offs	(84)	(12)	(55)	(221)	(12)	(50)	(434)
Recoveries	3		12	31	3	18	67
Provision for loan losses	33	467	154	202	2	46	904
Allowance for loan losses, September 30, 2011	\$ 3,722	\$ 4,854	\$ 2,011	\$ 1,412	\$ 97	\$ 156	\$ 12,252

Transactions in the allowance for loan losses for the nine months ended September 30, 2011 were as follows:

	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses, January 1, 2011	\$ 3,517	\$ 3,511	\$ 1,916	\$ 1,561	\$ 96	\$ 219	\$ 10,820
Charge-offs	(299)	(100)	(132)	(683)	(37)	(165)	(1,416)
Recoveries	7		12	76	8	72	175
Provision for loan losses	497	1,443	215	458	30	30	2,673

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Allowance for loan losses, September 30, 2011	\$	3,722	\$	4,854	\$	2,011	\$	1,412	\$	97	\$	156	\$	12,252
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Transactions in the allowance for loan losses for the three months ended September 30, 2010 were as follows:

Allowance for loan losses, July 1, 2010	\$ 10,415
Charge-off	(503)
Recoveries	65
Provision for loan losses	853
Allowance for loan losses, September 30, 2010	\$ 10,830

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Transactions in the allowance for loan losses for the nine months ended September 30, 2010 were as follows:

Allowance for loan losses, January 1, 2010	\$ 9,795
Charge-off	(1,759)
Recoveries	195
Provision for loan losses	2,599
 Allowance for loan losses, September 30, 2010	 \$ 10,830

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and is based on the Corporation's impairment method as of September 30, 2011:

	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 40	\$ 1,323	\$ 43	\$	\$	\$	\$ 1,406
Collectively evaluated for impairment	3,682	3,297	1,968	1,412	97	156	10,612
Modified in a troubled debt restructuring		234					234
 Total ending allowance balance	 \$ 3,722	 \$ 4,854	 \$ 2,011	 \$ 1,412	 \$ 97	 \$ 156	 \$ 12,252
 Loans:							
Loans individually evaluated for impairment	\$ 2,466	\$ 13,703	\$ 165	\$	\$	\$	\$ 16,334
Loans collectively evaluated for impairment	245,162	218,983	293,718	54,766	2,968	293	815,890
Loans modified in a troubled debt restructuring		6,279					6,279
 Total ending loans balance	 \$ 247,628	 \$ 238,965	 \$ 293,883	 \$ 54,766	 \$ 2,968	 \$ 293	 \$ 838,503

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and is based on the Corporation's impairment method as of December 31, 2010:

	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 142	\$ 509	\$ 69	\$	\$	\$	\$ 720
Collectively evaluated for impairment	3,375	2,759	1,847	1,561	96	219	9,857
Modified in a troubled debt restructuring		243					243
 Total ending allowance balance	 \$ 3,517	 \$ 3,511	 \$ 1,916	 \$ 1,561	 \$ 96	 \$ 219	 \$ 10,820
 Loans:							
Loans individually evaluated for impairment	\$ 2,616	\$ 8,759	\$ 235	\$	\$	\$	\$ 11,610
Loans collectively evaluated for impairment	254,875	202,405	266,369	53,202	2,870	3,964	783,685

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Loans modified in a troubled debt restructuring 1,714 1,714

Total ending loans balance \$ 257,491 \$ 212,878 \$ 266,604 \$ 53,202 \$ 2,870 \$ 3,964 \$ 797,009

The following tables present information related to loans individually evaluated for impairment by portfolio segment as of and for the three and nine months ended September 30, 2011:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With an allowance recorded:			
Commercial, industrial, and agricultural	\$ 337	\$ 337	\$ 40
Commercial mortgage	6,648	5,772	1,323
Residential real estate	265	165	43
With no related allowance recorded:			
Commercial, industrial, and agricultural	2,577	2,129	
Commercial mortgage	9,404	7,931	
Residential real estate			
Total	\$ 19,231	\$ 16,334	\$ 1,406

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	Three Months Ended			Nine Months Ended		
	September 30, 2011			September 30, 2011		
	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With an allowance recorded:						
Commercial, industrial, and agricultural	\$ 1,097	\$	\$	\$ 1,330	\$	\$
Commercial mortgage	6,554			8,050	16	16
Residential real estate	175	3	3	193	3	3
With no related allowance recorded:						
Commercial, industrial, and agricultural	1,525			1,738		
Commercial mortgage	7,831			4,275		
Residential real estate						
Total	\$ 17,182	\$ 3	\$ 3	\$ 15,586	\$ 19	\$ 19

The following table presents information related to loans individually evaluated for impairment by portfolio segment as of December 31, 2010:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With an allowance recorded:			
Commercial, industrial, and agricultural	\$ 3,041	\$ 2,616	\$ 142
Commercial mortgage	13,070	10,473	752
Residential real estate	339	235	69
With no related allowance recorded:			
Commercial, industrial, and agricultural			
Commercial mortgage			
Residential real estate			
Total	\$ 16,450	\$ 13,324	\$ 963

The unpaid principal balance of impaired loans includes the Corporation's recorded investment in the loan and amounts that have been charged off.

The following table presents information for loans individually evaluated for impairment during the three months ended September 30, 2010:

Average of individually impaired loans during period	\$ 14,669
Interest income recognized during impairment	26
Cash basis interest income recognized during impairment	26

The following table presents information for loans individually evaluated for impairment during the nine months ended September 30, 2010:

Average of individually impaired loans during period	\$ 14,239
Interest income recognized during impairment	366
Cash basis interest income recognized during impairment	366

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The following tables present the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual by portfolio segment as of September 30, 2011 and December 31, 2010:

September 30, 2011	Nonaccrual	Past Due Over 90 Days Still on Accrual
Commercial, industrial, and agricultural	\$ 2,466	\$ 53
Commercial mortgages	13,562	1,495
Residential real estate	1,237	120
Consumer	5	146
Credit cards		20
Total	\$ 17,270	\$ 1,834

December 31, 2010	Nonaccrual	Past Due Over 90 Days Still on Accrual
Commercial, industrial, and agricultural	\$ 2,344	\$ 23
Commercial mortgages	8,276	321
Residential real estate	1,306	386
Consumer		154
Credit cards		5
Total	\$ 11,926	\$ 889

Nonaccrual loans and loans past due over 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following tables present the aging of the recorded investment in past due loans as of September 30, 2011 and December 31, 2010 by class of loans:

September 30, 2011	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial, industrial, and agricultural	\$ 152	\$ 341	\$ 8,718	\$ 9,211	\$ 238,417	\$ 247,628
Commercial mortgages	1,344	1,982	8,858	12,184	226,781	238,965
Residential real estate	1,431	630	1,357	3,418	290,465	293,883
Consumer	437	128	151	716	54,050	54,766
Credit cards	27	3	20	50	2,918	2,968
Overdrafts					293	293
Total	\$ 3,391	\$ 3,084	\$ 19,104	\$ 25,579	\$ 812,924	\$ 838,503

December 31, 2010	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Loans Not Past Due	Total

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	Past Due					
Commercial, industrial, and agricultural	\$ 225	\$ 2,512	\$ 2,367	\$ 5,104	\$ 252,387	\$ 257,491
Commercial mortgages	129	1,184	8,597	9,910	202,968	212,878
Residential real estate	1,629	262	1,692	3,583	263,021	266,604
Consumer	455	145	154	754	52,448	53,202
Credit cards	20	10	5	35	2,835	2,870
Overdrafts					3,964	3,964
Total	\$ 2,458	\$ 4,113	\$ 12,815	\$ 19,386	\$ 777,623	\$ 797,009

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Troubled Debt Restructurings

The Corporation has allocated \$234 and \$243 of specific reserves to one commercial mortgage customer whose loan terms have been modified in troubled debt restructurings as of September 30, 2011 and December 31, 2010, respectively. The interest rate on the original loan was 6.60%. Due to financial difficulties experienced by the customer, the interest rate was reduced to 4.19% in the third quarter of 2010, resulting in an additional provision for loan losses of \$253 thousand for the three and nine months ended September 30, 2010. The interest rate on this loan was further reduced to 4.07% in the third quarter of 2011, resulting in an additional provision for loan losses of \$5 thousand for the three and nine months ended September 30, 2011. This loan had a total recorded investment of \$1,676 and \$1,714 as of September 30, 2011 and December 31, 2010, respectively.

In addition, the Corporation has one commercial mortgage customer whose loan relationships have interest-only terms that were extended during 2011. The original interest rates on the loans, which are also currently the market rates of interest, were not reduced; therefore, no additional provision for loan losses was required to be recorded. These loans have a total recorded investment of \$4,603 at September 30, 2011.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without a loan modification. This evaluation is performed using the Corporation's internal underwriting policies.

All loans modified in troubled debt restructurings are performing in accordance with their modified terms as of September 30, 2011. The Corporation has no further loan commitments to customers whose loans are classified as a troubled debt restructuring.

Credit Quality Indicators

The Corporation classifies commercial, industrial, and agricultural loans and commercial mortgage loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. Loans with an outstanding balance greater than \$1 million are analyzed bi-annually and loans with an outstanding balance of less than \$1 million are analyzed at least annually.

The Corporation uses the following definitions for risk ratings:

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Corporation's credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

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Loans not rated as special mention, substandard, or doubtful are considered to be pass rated loans. All loans included in the following tables have been assigned a risk rating within 12 months of the balance sheet date.

September 30, 2011	Pass	Special Mention	Substandard	Doubtful	Total
Commercial, industrial, and agricultural	\$ 213,927	\$ 14,974	\$ 18,727		\$ 247,628
Commercial mortgages	209,484	2,479	26,881	121	238,965
Total	\$ 423,411	\$ 17,453	\$ 45,608	\$ 121	\$ 486,593

December 31, 2010	Pass	Special Mention	Substandard	Doubtful	Total
Commercial, industrial, and agricultural	\$ 223,196	\$ 4,830	\$ 29,450	\$ 15	\$ 257,491
Commercial mortgages	188,846	7,673	16,249	110	212,878
Total	\$ 412,042	\$ 12,503	\$ 45,699	\$ 125	\$ 470,369

The Corporation's portfolio of residential real estate and consumer loans maintained within Holiday Financial Services Corporation (Holiday), a subsidiary that offers small balance unsecured and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics than are typical in the Bank's consumer loan portfolio, are considered to be subprime loans. Holiday's loan portfolio is summarized as follows at September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Consumer	\$ 17,649	\$ 16,532
Residential real estate	1,019	1,149
Less: unearned discount	(2,837)	(2,447)
Total	\$ 15,831	\$ 15,234

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential real estate and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of September 30, 2011 and December 31, 2010:

	September 30, 2011		December 31, 2010	
	Residential Real Estate	Consumer	Residential Real Estate	Consumer
Performing	\$ 292,526	\$ 54,615	\$ 264,912	\$ 53,048
Non-performing	1,357	151	1,692	154
Total	\$ 293,883	\$ 54,766	\$ 266,604	\$ 53,202

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As a member of the Federal Home Loan Bank of Pittsburgh (FHLB), the Corporation is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be sold to the FHLB or to another member institution, and all sales of FHLB stock must be at par. As a result of these restrictions, FHLB stock is unlike other investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules and not by market participants.

As of September 30, 2011, the Corporation holds \$5,502 of stock in FHLB. In December 2008, the FHLB voluntarily suspended dividend payments on its stock, as well as the repurchase of excess stock from members. The FHLB cited a significant reduction in the level of core earnings resulting from lower short-term interest rates, the increased cost of liquidity, and constrained access to the debt markets at attractive rates and maturities as the main reasons for the decision to suspend dividends and the repurchase of excess capital stock. The FHLB last paid a dividend in the third quarter of 2008.

FHLB stock is held as a long-term investment and its value is determined based on the ultimate recoverability of the par value. The Company evaluates impairment quarterly. The decision of whether impairment exists is a matter of judgment that reflects our view of the FHLB's long-term performance, which includes factors such as the following:

its operating performance;

the severity and duration of declines in the fair value of its net assets related to its capital stock amount;

its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance;

the impact of legislative and regulatory changes on the FHLB, and accordingly, on the members of FHLB; and

its liquidity and funding position.

After evaluating all of these considerations, the Corporation concluded that the par value of its investment in FHLB stock will be recovered. Accordingly, no impairment charge was recorded on these securities. Our evaluation of the factors described above in future periods could result in the recognition of impairment charges on FHLB stock.

DEPOSITS

Total deposits at September 30, 2011 and December 31, 2010 are summarized as follows (in thousands):

	Percentage Change	September 30, 2011	December 31, 2010
Checking, non-interest bearing	8.0%	\$ 152,127	\$ 140,836
Checking, interest bearing	7.8%	306,753	284,538
Savings accounts	49.3%	549,636	368,055
Certificates of deposit	(21.8%)	289,046	369,439
	11.6%	\$ 1,297,562	\$ 1,162,868

EARNINGS PER SHARE

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Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under certain stock compensation plans. For the three and nine months ended September 30, 2011, 107,375 and 75,500 shares issuable pursuant to outstanding stock options were excluded from the diluted earnings per share calculations since they were anti-dilutive. For the three and nine months ended September 30, 2010, 119,875 and 86,750 shares issuable pursuant to outstanding stock options, respectively, were excluded from the diluted earnings per share calculations since they were anti-dilutive.

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Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The Corporation has determined that its outstanding non-vested stock awards are participating securities.

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

	Three months		Nine months	
	ended		ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Basic earnings per common share computation:				
Distributed earnings allocated to common stock	\$ 2,025	\$ 2,008	\$ 6,064	\$ 4,900
Undistributed earnings allocated to common stock	2,030	1,090	5,137	3,462
Net earnings allocated to common stock	\$ 4,055	\$ 3,098	\$ 11,201	\$ 8,362
Weighted average common shares outstanding, including shares considered participating securities				
Weighted average common shares outstanding, including shares considered participating securities	12,315	12,203	12,290	10,092
Less: Average participating securities	(31)	(28)	(35)	(31)
Weighted average shares	12,284	12,175	12,255	10,061
Basic earnings per common share	\$ 0.33	\$ 0.25	\$ 0.91	\$ 0.83
Diluted earnings per common share computation:				
Net earnings allocated to common stock	\$ 4,055	\$ 3,098	\$ 11,201	\$ 8,362
Weighted average common shares outstanding for basic earnings per common share				
Weighted average common shares outstanding for basic earnings per common share	12,284	12,175	12,255	10,061
Add: Dilutive effects of assumed exercises of stock options	6	5	7	9
Weighted average shares and dilutive potential common shares	12,290	12,180	12,262	10,070
Diluted earnings per common share	\$ 0.33	\$ 0.25	\$ 0.91	\$ 0.83

DERIVATIVE INSTRUMENTS

The Corporation records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

For derivatives designated as cash flow hedges, the effective portion of the changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified into earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Corporation assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged item or transaction.

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On August 1, 2008, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2008 in order to hedge \$10 million of a subordinated note that was issued by the Corporation during 2007 and elected cash flow hedge accounting for the agreement. The Corporation's objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from August 1, 2008 to September 15, 2013 without exchange of the underlying notional amount. At September 30, 2011, the variable rate on the subordinated debt was 1.90% (LIBOR plus 155 basis points) and the Corporation was paying 5.84% (4.29% fixed rate plus 155 basis points).

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In anticipation of the expiration of the 5 year interest rate swap agreement discussed immediately above, on May 3, 2011, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2013 which as of that effective date, will hedge \$10 million of the subordinated note discussed immediately above. As with the prior interest rate swap agreement, the Corporation's objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2013 to September 15, 2018 without exchange of the underlying notional amount. On the effective date, the variable rate on the subordinated debt will be LIBOR plus 155 basis points and the Corporation will be paying 5.57% (4.02% fixed rate plus 155 basis points).

As of September 30, 2011, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Corporation does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

The following tables provide information about the amounts and locations of activity related to the interest rate swaps designated as cash flow hedges within the Corporation's consolidated balance sheet and statement of income as of and for the three and nine months ended September 30, 2011 (in thousands):

As of September 30, 2011	Liability Derivative Balance Sheet Location	Fair Value
Interest rate contract	Accrued interest payable and other liabilities	(\$ 1,665)

For the Three Months Ended September 30, 2011	(a)	(b)	(c)	(d)	(e)
Interest rate contract	(\$ 441)	Interest expense subordinated debentures	(\$ 103)	Other income	\$

For the Nine Months Ended September 30, 2011	(a)	(b)	(c)	(d)	(e)
Interest rate contract	(\$ 519)	Interest expense subordinated debentures	(\$ 303)	Other income	\$

- (a) Amount of Gain or (Loss) Recognized in Other Comprehensive Loss on Derivative (Effective Portion), net of tax
 - (b) Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
 - (c) Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
 - (d) Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
 - (e) Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
- Amounts reported in accumulated other comprehensive loss related to the interest rate swap will be reclassified to interest expense as interest payments are made on the subordinated debentures. Such amounts reclassified from accumulated other comprehensive loss to interest expense in the next 12 months are expected to approximate \$394.

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In December 2010, the FASB issued Accounting Standards Update No. 2010-29, Disclosure of Supplementary Pro Forma Information for Business Combinations. This update addresses diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The amendments in the update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The effect of adopting this new guidance did not have a material effect on the Corporation's financial statements.

In April 2011, the FASB issued Accounting Standards Update No. 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. This update clarifies guidance on a creditor's evaluation of whether it has granted a concession to a borrower and a creditor's evaluation of whether a borrower is experiencing financial difficulties. The amendments in this update are effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. In addition, an entity should disclose the information required by Accounting Standards Codification paragraphs 310-10-50-33 through 50-34, which was deferred by Accounting Standards Update No. 2011-01, for interim and annual periods beginning on or after June 15, 2011. The effect of adopting this new guidance did not have a material effect on the Corporation's financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-4, Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. Some amendments in this update clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this update are effective during interim and annual reporting periods beginning after December 15, 2011. The effect of adopting this new guidance is not expected to have a material effect on the Corporation's financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-5, Comprehensive Income (Topic 220), Presentation of Comprehensive Income. This update amends the FASB Accounting Standards Codification (Codification) to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This update eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments to the Codification in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and retrospective application is required. The effect of adopting this new guidance is not expected to have a material effect on the Corporation's financial statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Intangibles—Goodwill and Other (Topic 350), Testing Goodwill for Impairment. The amendments in the update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than fifty percent. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The effect of adopting this new guidance is not expected to have a material effect on the Corporation's financial statements.

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ITEM 2

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

The following discussion and analysis of the consolidated financial statements of CNB Financial Corporation (the Corporation) is presented to provide insight into management's assessment of financial results. The Corporation's principal subsidiary, CNB Bank (the Bank), provides financial services to individuals and businesses primarily within the west central Pennsylvania counties of Cambria, Cameron, Clearfield, Elk, Indiana, McKean and Warren. It also includes a portion of western Centre County including Philipsburg Borough, Rush Township and the western portions of Snow Shoe and Burnside Townships and a portion of Jefferson County, consisting of the boroughs of Brockway, Falls Creek, Punxsutawney, Reynoldsville and Sykesville, and the townships of Washington, Winslow and Henderson. ERIEBANK, a division of CNB Bank, provides financial services to individuals and businesses in the northwestern Pennsylvania counties of Erie and Crawford.

The Bank is subject to regulation, supervision and examination by the Pennsylvania State Department of Banking as well as the Federal Deposit Insurance Corporation. The financial condition and results of operations of the Corporation and its consolidated subsidiaries are not necessarily indicative of future performance. One of the Corporation's subsidiaries, CNB Securities Corporation, is incorporated in Delaware and currently maintains investments in debt and equity securities. County Reinsurance Company, also a subsidiary, is an Arizona Corporation, and provides credit life and disability insurance for customers of CNB Bank. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Holiday Financial Services Corporation, incorporated in Pennsylvania, offers small balance unsecured loans and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics. When we use the terms we, us and our, we mean CNB Financial Corporation and its subsidiaries. Management's discussion and analysis should be read in conjunction with the Corporation's consolidated financial statements and related notes.

GENERAL OVERVIEW

The Corporation expanded its ERIEBANK division by opening a full service office in Meadville, Pennsylvania in the second quarter of 2010. In addition, a CNB Bank branch was opened in Kylertown, Pennsylvania in the third quarter of 2010, and a CNB Bank loan production office was opened in Indiana, Pennsylvania in the third quarter of 2011. A CNB Bank loan production office in Johnstown, Pennsylvania was closed in the third quarter of 2011. Management believes that our ERIEBANK division, along with our traditional CNB Bank market areas, should provide the Bank with sustained loan growth during 2011. Deposit growth was significant in 2010 and the first nine months of 2011.

Management concentrates on return on average equity and earnings per share metrics, plus other methods to measure the performance of the Corporation. The interest rate environment will continue to play an important role in the future earnings of the Corporation. We experienced some compression of our net interest margin in the first nine months of 2011 as a result of the current interest rate environment. During the past several years, we have taken measures such as instituting rate floors on our commercial lines of credit and home equity lines to better address the historic lows on various key interest rates such as the Prime Rate and 3-month LIBOR. In addition, we decreased interest rates on certain deposit products during 2011 and 2010.

The Dodd-Frank Wall Street and Consumer Protection Act (the Dodd-Frank Act), enacted in July 2010, includes numerous provisions designed to strengthen the financial industry, enhance consumer protection, expand disclosures and provide for transparency. Some of these provisions include changes to FDIC insurance coverage, which includes a permanent increase in the coverage to \$250,000. Additional provisions create a Consumer Financial Protection Bureau, which is authorized to write rules on all consumer financial products, and a Financial Services Oversight Council, which is empowered to determine which entities are systematically significant and require tougher regulations and is charged with reviewing, and when appropriate, submitting comments to the Securities and Exchange Commission and Financial Accounting Standards Board with respect to existing or proposed accounting principles, standards or procedures. Although the aforementioned provisions are only a few of the numerous ones included in the Dodd-Frank Act, the full impact of the entire Dodd-Frank Act will not be known until the implementation, which is ongoing, is completed.

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CASH AND CASH EQUIVALENTS

Cash and cash equivalents totaled \$41.2 million at September 30, 2011 compared to \$37.4 million at December 31, 2010. Cash and cash equivalents will fluctuate based on the timing and amount of liquidity events that occur in the normal course of business.

We believe the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable the Corporation to meet cash obligations and off-balance sheet commitments as they come due.

SECURITIES

Securities available for sale and trading securities have combined to increase \$92.2 million or 18.3% since December 31, 2010. The increase is primarily due to the purchases of residential mortgage and asset backed securities issued by government sponsored entities as well as securities issued by municipal governments, and resulted from deposit growth not reinvested in loans.

The Corporation's structured pooled trust preferred securities currently do not trade in an active, open market with readily observable prices and are therefore classified within Level 3 of the valuation hierarchy. The fair value of these securities has been calculated using a discounted cash flow model and market liquidity premium. With the current market conditions, the assumptions used to determine the fair value of Level 3 securities has greater subjectivity due to the lack of observable market transactions. The fair values of these securities have declined due to the fact that the subsequent offerings of similar securities pay a higher market rate of return. The higher rate of return reflects the increased credit and liquidity risks in the market.

When the structured pooled trust preferred securities were purchased, they were considered to be investment grade based on ratings assigned by Moody's. As a result of liquidity disruptions within the credit markets and the generally stressed conditions within the financial services industry, Moody's downgraded the rating of these securities since they were purchased by the Corporation. As of September 30, 2011, the Corporation held one structured pooled trust preferred security rated Ca by Moody's having an amortized cost of \$800 thousand and fair value of \$240 thousand. The present value of the projected cash flows for this security was sufficient for full repayment of the amortized cost; therefore, it is believed the decline in fair value is temporary due to current market conditions. However, the Corporation believes that without improved market conditions, other-than-temporary impairments may occur in future periods.

In addition, the Corporation holds two structured pooled trust preferred securities for which an impairment charge of \$398 thousand was recorded during the nine months ended September 30, 2011 because the present value of the projected cash flows was not sufficient for repayment of any of the amortized cost of the securities.

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

LOANS

The Corporation experienced an increase in loans, net of unearned discount, of \$41.1 million, or 5.2%, during the first nine months of 2011. Our lending is focused in the west, central and northwest Pennsylvania markets and consists principally of commercial and retail lending, which includes single family residential mortgages and other consumer loans. The Corporation views commercial lending as its competitive advantage and continues to focus on this area by hiring and retaining experienced loan officers and supporting them with quality credit analysis. The Corporation expects sustained loan demand throughout the remainder of 2011.

Table of Contents**ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is established by provisions for losses in the loan portfolio as well as overdrafts in deposit accounts. These provisions are charged against current income. Loans and overdrafts deemed not collectible are charged off against the allowance while any subsequent collections are recorded as recoveries and increase the allowance. The table below shows activity within the allowance account for the specified periods (in thousands):

	Nine months ending September 30, 2011	Year ending December 31, 2010	Nine months ending September 30, 2010
Balance at beginning of period	\$ 10,820	\$ 9,795	\$ 9,795
Charge-offs:			
Commercial, industrial, and agricultural	299	543	293
Commercial mortgages	100	2,061	166
Residential real estate	132	211	184
Consumer	683	1,223	875
Credit cards	37	94	63
Overdrafts	165	239	178
	1,416	4,371	1,759
Recoveries:			
Commercial, industrial, and agricultural	7	11	9
Commercial mortgages		3	4
Residential real estate	12	2	3
Consumer	76	100	81
Credit cards	8	10	10
Overdraft deposit accounts	72	112	88
	175	238	195
Net charge-offs	(1,241)	(4,133)	(1,564)
Provision for loan losses	2,673	5,158	2,599
Balance at end of period	\$ 12,252	\$ 10,820	\$ 10,830
Loans, net of unearned	\$ 835,666	\$ 794,562	\$ 752,945
Allowance to net loans	1.47%	1.36%	1.44%
Net charge-offs to average loans (annualized)	0.20%	0.56%	0.29%
Nonperforming assets	\$ 19,463	\$ 13,211	\$ 7,587
Nonperforming % of total assets	1.26%	0.93%	0.56%

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

The remaining loans are pooled, by category, into these segments:

Reviewed

Commercial, industrial, and agricultural

Homogeneous Commercial mortgages

Residential real estate

Consumer

Credit cards

Overdrafts

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The reviewed loan pools are further segregated into four categories: special mention, substandard, doubtful, and unclassified. Historical loss factors are calculated for each pool excluding overdrafts based on the previous eight quarters of experience. The homogeneous pools are evaluated by analyzing the historical loss factors from the most previous quarter end and the two most recent year ends. The historical loss factors for both the reviewed and homogeneous pools are adjusted based on these six qualitative factors:

levels of and trends in delinquencies, non-accrual loans, and classified loans;

trends in volume and terms of loans;

effects of any changes in lending policies and procedures;

experience, ability and depth of management;

national and local economic trends and conditions; and

concentrations of credit.

The methodology described above was created using the experience of our credit administrator, guidance from the regulatory agencies, expertise of our third party loan review provider, and discussions with our peers. The resulting factors are applied to the pool balances in order to estimate the probable risk of loss within each pool. Prudent business practices dictate that the level of the allowance, as well as corresponding charges to the provision for loan losses, should be commensurate with identified areas of risk within the loan portfolio and the attendant risks inherent therein. The quality of the credit risk management function and the overall administration of this vital segment of the Corporation's assets are critical to the ongoing success of the Corporation.

The previously mentioned analysis considered numerous historical and other factors to analyze the adequacy of the allowance and current period charges against the provision for loan losses. Management paid special attention to a section of the analysis that compared and plotted the actual level of the allowance against the aggregate amount of loans adversely classified in order to compute the estimated probable losses associated with those loans. By noting the spread at the present time, as well as prior periods, management can determine the current adequacy of the allowance as well as evaluate trends that may be developing. The volume and composition of the Corporation's loan portfolio continue to reflect growth in commercial credits including commercial real estate loans.

As mentioned in the Loans section of this analysis, management considers commercial lending to be a competitive advantage and continues to focus on this area as part of its strategic growth initiatives. However, management must also consider the fact that the inherent risk is more pronounced in these types of credits and is also driven by the economic environment within its market areas.

During the nine months ended September 30, 2011, the Corporation recorded a provision for loan losses of \$2.7 million, as compared to a provision for loan losses of \$2.6 million for the nine months ended September 30, 2010. One relationship comprising three commercial loans became impaired in the first quarter of 2011, resulting in an increase in nonperforming assets of \$4.4 million as of the end of the first quarter. As of September 30, 2011, one of these loans in the amount of \$1.4 million remains nonperforming. Based on CNB's evaluation of the underlying collateral, no losses associated with this relationship are expected.

One relationship comprising two commercial loans became impaired in the second quarter of 2011, resulting in an increase in non-accrual loans of \$4.2 million and an increase in the provision and allowance for loan losses of \$1.0 million during the nine months ended September 30, 2011. This increase in the provision and allowance for loan losses was offset by a decrease in the provision for loan losses resulting from a decrease in net loan chargeoffs from \$1.8 million for the nine months ended September 30, 2010 to \$1.4 million for the nine months ended September 30, 2011.

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Management believes that both its 2011 provision and allowance for loan losses are reasonable and adequate to absorb probable incurred losses in its portfolio at September 30, 2011.

BANK OWNED LIFE INSURANCE

The Corporation has periodically purchased Bank Owned Life Insurance (BOLI). The policies cover executive officers and a select group of other employees with the Bank being named as beneficiary. Earnings from the BOLI assist the Corporation in offsetting its benefit costs. During the first quarter of 2011, additional BOLI of \$5.0 million was purchased.

Table of Contents**FUNDING SOURCES**

The Corporation considers deposits, short-term borrowings, and term debt when evaluating funding sources. Traditional deposits continue to be the main source of funds in the Corporation, increasing \$134.7 million from \$1,162.9 million at December 31, 2010 to \$1,297.6 million at September 30, 2011. The growth in deposits was primarily due to increases in savings accounts of \$181.6 million over this period as a result of the Corporation's marketing of a new savings product which carries an annual percentage yield which is highly competitive in the current interest rate environment. This increase in savings accounts was offset by an expected decrease in time deposits of \$80.4 million as customers who previously held certificates of deposit migrate to the new savings product.

Periodically, the Corporation utilizes term borrowings from the Federal Home Loan Bank (FHLB) and other lenders to meet funding needs. Management plans to maintain access to short- and long-term borrowings as an available funding source when deemed appropriate.

SHAREHOLDERS EQUITY AND CAPITAL RATIOS AND METRICS

The Corporation's capital continued to provide a base for profitable growth through September 30, 2011. Total shareholders' equity was \$130.4 million at September 30, 2011 and \$109.6 million at December 31, 2010. In the first nine months of 2011, the Corporation earned \$11.2 million and declared dividends of \$6.1 million, a dividend payout ratio of 54.2% of net income. The Corporation has also complied with the standards of capital adequacy mandated by the banking regulators. Bank regulators have established risk-based capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of various assets banks hold in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, or 100% (highest risk assets) is assigned to each asset on the balance sheet.

The Corporation's capital ratios, book value per share and tangible book value per share as of September 30, 2011 and December 31, 2010 are as follows:

	September 30, 2011	December 31, 2010
Total risk-based capital ratio	15.28%	15.38%
Tier 1 capital ratio	14.03%	14.13%
Leverage ratio	8.44%	8.81%
Tangible common equity/tangible assets (1)	7.80%	7.05%
Book value per share	\$ 10.58	\$ 8.96
Tangible book value per share (1)	\$ 9.70	\$ 8.08

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- (1) Tangible common equity, tangible assets and tangible book value per share are non-GAAP financial measures calculated using GAAP amounts. Tangible common equity is calculated by excluding the balance of goodwill from the calculation of shareholders' equity. Tangible assets is calculated by excluding the balance of goodwill from the calculation of total assets. Tangible book value per share is calculated by dividing tangible common equity by the number of shares outstanding. The Corporation believes that these non-GAAP financial measures provide information to investors that is useful in understanding its financial condition because they are additional measures used to assess capital adequacy. Because not all companies use the same calculation of tangible common equity and tangible assets, this presentation may not be comparable to other similarly titled measures calculated by other companies. A reconciliation of these non-GAAP financial measures is provided below (dollars in thousands, except per share data).

	September 30, 2011	December 31, 2010
Shareholders' equity	\$ 130,431	\$ 109,645
Less goodwill	10,821	10,821
Tangible common equity	\$ 119,610	\$ 98,824
Total assets	\$ 1,543,672	\$ 1,413,511
Less goodwill	10,821	10,821
Tangible assets	\$ 1,532,851	\$ 1,402,690
Ending shares outstanding	12,327,743	12,237,261
Tangible book value per share	\$ 9.70	\$ 8.08
Tangible common equity/tangible assets	7.80%	7.05%

LIQUIDITY

Liquidity measures an organization's ability to meet cash obligations as they come due. The consolidated statement of cash flows presented on page 5 provides analysis of the Corporation's cash and cash equivalents. Additionally, management considers that portion of the loan and investment portfolio that matures within one year to be part of the Corporation's liquid assets. The Corporation's liquidity is monitored by both management and the ALCO, which establishes and monitors ranges of acceptable liquidity. Management believes the Corporation's current liquidity position is acceptable.

OFF BALANCE SHEET ACTIVITIES

Some financial instruments, such as loan commitments, credit lines, letters of credit and overdraft protection, are issued to meet customer financing needs. The contractual amount of financial instruments with off-balance sheet risk was as follows at September 30, 2011 (in thousands):

Commitments to extend credit	\$ 224,227
Standby letters of credit	22,821
	\$ 247,048

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CONSOLIDATED YIELD COMPARISONS

AVERAGE BALANCES AND NET INTEREST MARGIN FOR THE NINE MONTHS ENDED

Dollars in thousands

	September 30, 2011			September 30, 2010		
	Average Balance	Annual Rate	Interest Inc./Exp.	Average Balance	Annual Rate	Interest Inc./Exp.
ASSETS:						
Interest-bearing deposits with other banks	\$ 14,018	0.97%	\$ 102	\$ 7,254	1.62%	\$ 88
Securities:						
Taxable (1)	471,726	3.03%	10,640	374,871	3.01%	8,539
Tax-Exempt (1,2)	82,340	5.22%	3,138	62,691	5.46%	2,505
Equity Securities (1,2)	1,723	2.42%	31	1,620	2.14%	26
Total securities	555,789	3.35%	13,809	439,182	3.35%	11,070
Loans:						
Commercial (2)	276,786	5.20%	10,793	256,141	5.70%	10,959
Mortgage (2)	484,936	5.72%	20,816	424,180	6.17%	19,640
Consumer	50,011	12.86%	4,822	50,058	13.02%	4,887
Total loans (3)	811,733	5.98%	36,431	730,379	6.48%	35,486
Total earning assets	1,381,540	4.88%	\$ 50,342	1,176,815	5.28%	\$ 46,644
Non interest-bearing assets:						
Cash and due from banks	33,570			34,957		
Premises and equipment	24,405			23,917		
Other assets	57,111			52,977		
Allowance for loan losses	(11,570)			(10,230)		
Total non interest-bearing assets	103,516			101,621		
TOTAL ASSETS	\$ 1,485,056			\$ 1,278,436		
LIABILITIES AND SHAREHOLDERS EQUITY:						
Demand - interest-bearing	\$ 294,054	0.80%	1,761	\$ 251,864	0.74%	1,403
Savings	465,215	1.14%	3,971	339,580	1.33%	3,378
Time	335,701	1.84%	4,628	343,258	2.08%	5,367

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Total interest-bearing deposits	1,094,970	1.26%	10,360	934,702	1.45%	10,148
Short-term borrowings	12,671	0.28%	27	2,708	0.15%	3
Long-term borrowings	74,032	4.23%	2,346	91,816	4.60%	3,167
Subordinated debentures	20,620	3.76%	582	20,620	3.79%	586
Total interest-bearing liabilities	1,202,293	1.48%	\$ 13,315	1,049,846	1.77%	\$ 13,904
Demand - non interest-bearing	147,193			123,834		
Other liabilities	16,116			13,060		
Total liabilities	1,365,602			1,186,740		
Shareholders' equity	119,454			91,696		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,485,056			\$ 1,278,436		
Interest income/Earning assets		4.88%	\$ 50,342		5.28%	\$ 46,644
Interest expense/Interest-bearing liabilities		1.48%	13,315		1.77%	13,904
Net interest spread		3.40%	\$ 37,027		3.51%	\$ 32,740
Interest income/Earning assets		4.88%	50,342		5.28%	46,644
Interest expense/Earning assets		1.29%	13,315		1.58%	13,904
Net interest margin		3.59%	\$ 37,027		3.70%	\$ 32,740

- (1) Includes unamortized discounts and premiums. Average balance is computed using the carrying value of securities. The average yield has been computed using the historical amortized cost average balance for available for sale securities.
- (2) Average yields are stated on a fully taxable equivalent basis.
- (3) Average outstanding includes the average balance outstanding of all non-accrual loans. Loans consist of the average of total loans less average unearned income. The amount of loan fees included in the interest income on loans is not material.

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RESULTS OF OPERATIONS

Three Months Ended September 30, 2011 and 2010

OVERVIEW OF THE INCOME STATEMENT

The Corporation had net income of \$4.1 million for the third quarter of 2011 compared to \$3.1 million for the same period of 2010. The earnings per diluted share were \$0.33 in the third quarter of 2011 and \$0.25 for the third quarter of 2010.

INTEREST INCOME AND EXPENSE

Net interest income totaled \$12.4 million, an increase of \$1.1 million, or 9.9%, over the third quarter of 2010. Total interest and dividend income increased by \$996 thousand, or 6.3%, as compared to the third quarter of 2010. Although the Corporation's earning assets continue to grow, these increases have been offset by decreases in the yield on earning assets, primarily because the composition of earning assets has shifted to a greater percentage of investment securities as deposit growth has exceeded loan growth. Total interest expense decreased \$119 thousand, or 2.6%, as compared to the third quarter of 2010 due to decreases in the cost of core deposits as well as the Corporation's repayment and refinancing of long-term debt in 2010.

PROVISION FOR LOAN LOSSES

The Corporation recorded a provision for loan losses of \$904 thousand in the third quarter of 2011 compared to \$853 thousand in the third quarter of 2010. Net loan chargeoffs were \$366 thousand in the third quarter of 2011 compared to \$438 thousand in the third quarter of 2010. However, due to increases in nonperforming assets, a slightly higher provision for loan losses was required in the third quarter of 2011 than in the third quarter of 2010.

Management believes the provision for loan losses is appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of September 30, 2011.

NON-INTEREST INCOME

Non-interest income totaled \$2.5 million, an increase of \$621 thousand, or 33.7%, over the third quarter of 2010. The Corporation recorded other-than-temporary impairment charges in the third quarter of 2010 of \$821 thousand, which were offset by realized gains on available-for-sale securities of \$118 thousand. No other-than-temporary impairment charges were recorded and realized gains totaled \$84 thousand in the third quarter of 2011. In addition, the Corporation recorded realized and unrealized gains (losses) during the quarters ended September 30, 2011 and 2010 of (\$313) thousand and \$15 thousand, respectively, for securities for which the fair value option was elected.

Excluding the effects of securities transactions, the Corporation's non-interest income increased \$162 thousand, or 6.4%, in the third quarter of 2011 as compared to the same period in 2010.

NON-INTEREST EXPENSES

Non-interest expenses totaled \$8.3 million, an increase of \$197 thousand, or 2.4%, over the third quarter of 2010. Salaries and benefits expenses increased \$404 thousand, or 10.1%, during the quarter ended September 30, 2011 compared to the quarter ended September 30, 2010, primarily as a result of an increase in full-time equivalent employees from 287 at September 30, 2010 to 297 at September 30, 2011. FDIC insurance expenses decreased \$187 thousand, or 43.8%, during the quarter ended September 30, 2011 compared to the quarter ended September 30, 2010 due to the change in the FDIC insurance calculation from a deposit based formula to a tangible assets based formula in the second quarter of 2011.

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INCOME TAX EXPENSE

Income tax expense was \$1.6 million in the third quarter of 2011 as compared to \$1.0 million in the third quarter of 2010, resulting in effective tax rates of 27.7% and 24.9% for the periods, respectively. The effective rates for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans as well as earnings from bank owned life insurance.

Nine Months Ended September 30, 2011 and 2010

OVERVIEW OF THE INCOME STATEMENT

The Corporation had net income of \$11.2 million for the nine months ended September 30, 2011 compared to \$8.4 million for the same period of 2010. The earnings per diluted share were \$0.91 for the nine months ended September 30, 2011 and \$0.83 for the nine months ended September 30, 2010. The return on assets and return on equity for the nine months ended September 30, 2011 are 1.01% and 12.54%, respectively, compared to 0.88% and 12.20%, respectively, for the same period of 2010.

INTEREST INCOME AND EXPENSE

During the nine months ended September 30, 2011, net interest income increased \$4.2 million, or 13.4%, compared to the comparable period in 2010. The Corporation's net interest margin on a fully tax equivalent basis was 3.59% for the nine months ended September 30, 2011, compared to 3.70% for the comparable period in 2010. Although the Corporation's earning assets continue to grow, these increases have been offset by decreases in the yield on earning assets, primarily because the composition of earning assets has shifted to a greater percentage of investment securities as deposit growth has exceeded loan growth. During the nine months ended September 30, 2011, total interest expense decreased \$589 thousand, or 4.2%, as compared to the comparable period in 2010 due to decreases in the cost of core deposits as well as the Corporation's repayment and refinancing of long-term debt in 2010.

PROVISION FOR LOAN LOSSES

The Corporation recorded a provision for loan losses of \$2.7 million for the nine months ended September 30, 2011 compared to \$2.6 million for the comparable period in 2010. Net loan chargeoffs were \$1.2 million in the first nine months of 2011 compared to \$1.6 million in the first nine months of 2010, and loan growth was consistent from the first nine months of 2010 to the first nine months of 2011. However, the Corporation recorded charge-offs in its commercial mortgage loan portfolio of \$1.9 million during the quarter ended December 31, 2010, as compared to \$381 thousand and \$178 thousand during the years ended December 31, 2009 and 2008. As a result, the Corporation's homogeneous loss pool associated with its commercial mortgage loan portfolio increased \$539 thousand during the nine months ended September 30, 2011. In combination, all of these factors resulted in a slightly higher provision for loan losses in the first nine months of 2011 than in the first nine months of 2010.

Management believes the provision for loan losses is appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of September 30, 2011.

NON-INTEREST INCOME

Non-interest income totaled \$7.3 million during the nine months ended September 30, 2011, an increase of \$1.3 million, or 22.0%, over the comparable period in 2010. During the nine months ended September 30, 2011, the Corporation recorded other-than-temporary impairment charges of \$398 thousand, which was offset by realized gains on available-for-sale securities of \$158 thousand. The Corporation recorded other-than-temporary impairment charges during the nine months ended September 30, 2010 of \$1.9 million, which was offset by realized gains on available-for-sale securities of \$691 thousand. In addition, the Corporation recorded realized and unrealized losses during the nine months ended September 30, 2011 and 2010 of \$216 and \$42, respectively, for securities for which the fair value option was elected.

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Excluding the effects of securities transactions, the Corporation's non-interest income was \$7.7 million for the nine months ended September 30, 2011, compared to \$7.2 million for the nine months ended September 30, 2010.

NON-INTEREST EXPENSES

Non-interest expenses increased \$1.1 million, or 4.8%, during the nine months ended September 30, 2011 compared to the comparable period in 2010. Salaries and benefits increased \$1.2 million, or 9.9%, during the nine months ended September 30, 2011 compared to the comparable period in 2010, primarily as a result of an increase in full-time equivalent employees from 287 at September 30, 2010 to 297 at September 30, 2011. FDIC insurance expenses decreased \$233 thousand, or 19.4%, during the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 due to the change in the FDIC insurance calculation from a deposit based formula to a tangible assets based formula in the second quarter of 2011.

INCOME TAX EXPENSE

Income tax expense was \$4.2 million for the nine months ended September 30, 2011 as compared to \$2.8 million for the same period of 2010, resulting in effective tax rates of 27.2% and 24.7% for the periods, respectively. The effective rates for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans as well as earnings from bank owned life insurance.

CRITICAL ACCOUNTING POLICIES

The Corporation's accounting and reporting policies are in accordance with GAAP and conform to general practices within the financial services industry. Accounting and reporting practices for the allowance for loan losses and fair value of securities are deemed critical since they involve the use of estimates and require significant management judgments. Application of assumptions different than those used by management could result in material changes in the Corporation's financial position or results of operations. Note 1 (Summary of Significant Accounting Policies), Note 3 (Securities), and Note 4 (Loans), of the Corporation's 2010 Form 10-K, provide detail with regard to the Corporation's accounting for the allowance for loan losses and fair value of securities. There have been no significant changes in the application of accounting policies since December 31, 2010.

ITEM 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates, and equity prices. As a financial holding company, the Corporation is primarily sensitive to the interest rate risk component. Changes in interest rates will affect the levels of income and expense recorded on a large portion of the Bank's assets and liabilities. Additionally, such fluctuations in interest rates will impact the market value of all interest sensitive assets. The ALCO is responsible for reviewing the Corporation's interest rate sensitivity position and establishing policies to control exposure to interest rate fluctuations. The primary goal established by these policies is to increase total income within acceptable risk limits.

The Corporation monitors interest rate risk through the use of two models: static gap and earnings simulation. Each model standing alone has limitations; however, taken together they represent, in management's opinion, a reasonable view of the Corporation's interest rate risk position.

STATIC GAP: Static gap analysis is intended to provide an approximation of projected repricing of assets and liabilities at a point in time on the basis of stated maturities, prepayments, and scheduled interest rate adjustments within selected time intervals. A gap is defined as the difference between the principal amount of assets and liabilities which reprice within those time intervals. The cumulative one year gap at September 30, 2011 was 12.09% of total earning assets compared to policy guidelines of plus or minus 15.0%. The ratio was 3.23% at December 31, 2010.

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Fixed rate securities, loans and CDs are included in the gap repricing based on time remaining until maturity. Mortgage prepayments are included in the time frame in which they are expected to be received.

Certain shortcomings are inherent in the method of analysis presented in Static Gap. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may not react correspondingly to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate with changes in market interest rates, while interest rates on other types of assets may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate loans, have features, like annual and lifetime rate caps, which restrict changes in interest rates both on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate from those assumed in the table. Finally, the ability of certain borrowers to make scheduled payments on their adjustable-rate loans may decrease in the event of an interest rate increase.

EARNINGS SIMULATION: This model forecasts the projected change in net interest income resulting from an increase or decrease in the federal funds rate. The model assumes a one time shock of plus or minus 200 basis points or 2%.

The model makes various assumptions about cash flows and reinvestments of these cash flows in different rate environments. Generally, repayments, maturities and calls are assumed to be reinvested in like instruments and no significant change in the balance sheet mix is assumed. Actual results could differ significantly from these estimates which would produce significant differences in the calculated projected change in income. The limits stated above do not necessarily represent measures that would be taken by management in order to stabilize income results. The instruments on the balance sheet react at different speeds to various changes in interest rates as discussed under Static Gap. In addition, there are strategies available to management that may help mitigate a decline in income caused by a rapid change in interest rates.

The following table below summarizes the information from the interest rate risk measures reflecting rate sensitive assets to rate sensitive liabilities at September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Static 1-Yr. Cumulative Gap	12.09%	3.23%
Earnings Simulation:		
-200 bps vs. Stable Rate	N/A	N/A
+200 bps vs. Stable Rate	16.53%	0.10%

The interest rate sensitivity position at both September 30, 2011 and December 31, 2010 was asset sensitive in the short term. As the federal funds rate was at 0.25% on September 30, 2011 and December 31, 2010, the -200 bps scenario has been excluded. Management measures the potential impact of significant changes in interest rates on both earnings and equity. By the use of computer generated models, the potential impact of these changes has been determined to be acceptable with modest effects on net income and equity given an interest rate shock of an increase in the federal funds rate of 2.0%. We continue to monitor the interest rate sensitivity through the ALCO and use the data to make strategic decisions.

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As of the end of the period covered by this quarterly report, an evaluation was carried out under the supervision and with the participation of the Corporation's management, including our Chief Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) (Exchange Act). Based on their evaluation, our Chief Executive Officer and Principal Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no changes in the Corporation's internal control over financial reporting that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS None

ITEM 1A. RISK FACTORS There have been no material changes to the risk factors disclosed in Part I, Item 1A. of the 2010 Form 10-K.

ITEM 6. EXHIBITS

Exhibit No.	Description
3.1	Amended and Restated Articles of Incorporation of the Corporation, filed as Appendix B to the 2005 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.
3.2	By-Laws of the Corporation, as amended and restated, filed as Appendix C to the 2005 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer
32.1	Section 1350 Certification
32.2	Section 1350 Certification
101	The following financial information from the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, furnished electronically herewith, and formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements, tagged as blocks of text.*

* In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

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SIGNATURES

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

CNB FINANCIAL CORPORATION
(Registrant)

DATE: November 9, 2011

/s/ Joseph B. Bower, Jr.
Joseph B. Bower, Jr.
President and Director
(Principal Executive Officer)

DATE: November 9, 2011

/s/ Brian W. Wingard
Brian W. Wingard
Interim Treasurer
(Principal Financial Officer)

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