CHARLES RIVER LABORATORIES INTERNATIONAL INC
Form 10-K
February 23, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

FOR THE FISCAL YEAR ENDED DECEMBER 27, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM TO
Commission File No. 001-15943

CHARLES RIVER LABORATORIES INTERNATIONAL, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**06-1397316**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
251 Ballardvale Street Wilmington, Massachusetts (Address of Principal Executive Offices)	**01887** (Zip Code)

(Registrant's telephone number, including area code): **(781) 222-6000**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company o

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

On June 28, 2008, the aggregate market value of the Registrant's voting common stock held by non-affiliates of the Registrant was approximately $4,303,090,433.

As of February 13, 2009, there were outstanding 66,789,799 shares of the Registrant's common stock, $0.01 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement for its 2009 Annual Meeting of Stockholders scheduled to be held on May 7, 2009, which will be filed with the Securities and Exchange Commission not later than 120 days after December 27, 2008, are incorporated by reference into Part III of this Annual Report on Form 10-K. With the exception of the portions of the 2009 Proxy Statement expressly incorporated into this Annual Report on Form 10-K by reference, such document shall not be deemed filed as part of this Form 10-K.

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ANNUAL REPORT ON FORM 10-K

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PART I

Item 1. Business

General

This Annual Report on Form 10-K contains forward-looking statements regarding future events and the future results of Charles River Laboratories International, Inc. that are based on current expectations, estimates, forecasts, and projections about the industries in which Charles River operates and the beliefs and assumptions of our management. Words such as "expect," "anticipate," "target," "goal," "project," "intend," "plan," "believe," "seek," "estimate," "will," "likely," "may," "designed," "would," "future," "can," "could" and other similar expressions that are predictions of or indicate future events and trends or which do not relate to historical matters are intended to identify such forward-looking statements. These statements are based on current expectations and beliefs of Charles River and involve a number of risks, uncertainties, and assumptions that are difficult to predict. For example, we may use forward-looking statements when addressing topics such as: future demand for drug discovery and development products and services, including the outsourcing of these services; present spending trends and other cost reduction activities by our customers (particularly in light of the challenging economic environment); future actions by our management; the outcome of contingencies; changes in our business strategy; changes in our business practices and methods of generating revenue; the development and performance of our services and products; market and industry conditions, including competitive and pricing trends; changes in the composition or level of our revenues; our cost structure; the impact of acquisitions and dispositions; the timing of the opening of new and expanded facilities; our expectations with respect to sales growth, efficiency improvements and operating synergies (including the impact of specific actions intended to cause related improvements); changes in our expectations regarding future stock option, restricted stock, performance awards and other equity grants to employees and directors; changes in our expectations regarding our stock repurchases; expectations with respect to foreign currency exchange; assessing (or changing our assessment of) our tax positions for financial statement purposes; and our cash flow and liquidity. In addition, these statements include the availability of funding for our customers and the impact of economic and market conditions on them generally the effects of our first quarter 2009 cost-saving actions and other actions designed to manage expenses, operating costs and capital spending and to streamline efficiency, the timing of our repatriation of accumulated income earned outside the United States and the ability of Charles River to withstand the current market conditions. You should not rely on forward-looking statements because they are predictions and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document or in the case of statements incorporated by reference, on the date of the document incorporated by reference. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Form 10-K under the section entitled "Our Strategy," the section entitled "Risks Related to Our Business and Industry," the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in our press releases and other financial filings with the Securities and Exchange Commission. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or risks. New information, future events or risks may cause the forward-looking events we discuss in this report not to occur.

Corporate History

Charles River has been operating since 1947 and during that time, we have undergone several changes to our business structure. Charles River Laboratories International, Inc. was incorporated in 1994. In 2000, we completed the initial public offering of Charles River Laboratories International, Inc. Our stock is traded on the New York Stock Exchange under the symbol "CRL "and is included in the Standard & Poor's MidCap 400, 1000 and Composite 1500 Indices, the Dow Jones US Biotechnology Index, the NYSE Composite Index and the NYSE Healthcare Sector Index, among others. We are

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headquartered in Wilmington, Massachusetts. Our headquarters mailing address is 251 Ballardvale Street, Wilmington, MA 01887, and the telephone number at that location is (781) 222-6000. Our Internet site is *www.criver.com*. Material contained on our Internet site is not incorporated by reference into this Form 10-K. Unless the context otherwise requires, references in this Form 10-K to "Charles River," "we," "us" or "our" refer to Charles River Laboratories International, Inc. and its subsidiaries.

This Form 10-K, as well as all other reports filed with the Securities and Exchange Commission are available free of charge through the Investor Relations section of our Internet site as soon as practicable after we electronically file such material with, or furnish it to, the SEC. You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. In addition, you may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (*http://www.sec.gov*) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Overview

We are a leading global provider of solutions that accelerate the drug discovery and development process, including research models and associated services, and outsourced preclinical services. The drug development process continues to require the steadily increasing investment of time and money various studies and reports estimate it takes between 10-15 years, between $800 million and $1 billion, and exploration of more than 10,000 drug compounds to produce a single FDA approved drug. Charles River is positioned to leverage our core competencies in laboratory animal medicine and science, and regulatory-compliant preclinical services in an efficient and cost-effective way to aid our customers in bringing their drugs to market faster.

We currently have two reporting segments: Research Models and Services (RMS) and Preclinical Services (PCS). We provide the animal research models required in research and development of new drugs, devices and therapies and have been in this business for 60 years. We have built upon our core competencies to develop a diverse and growing portfolio of products and services. Our wide array of tools and services enables our customers to reduce costs, increase speed and enhance their productivity and effectiveness in drug discovery and development. Our customer base includes global pharmaceutical companies, biotechnology companies, as well as government agencies, and leading hospitals and academic institutions around the world. We currently operate approximately 70 facilities in 17 countries worldwide. Our products and services, supported by our global infrastructure and deep scientific expertise, enable our customers to meet many of the challenges of early-stage life sciences research. In 2008, our net sales from continuing operations were $1.34 billion, and while we had a net operating loss of $521.8 million, this included a $700.0 million goodwill impairment charge.

In recent years, we have completed a number of acquisitions that have broadened our present portfolio of high-end services to include general toxicology, specialty toxicology, discovery and imaging services, biopharmaceutical services and Phase I clinical services. In addition, these acquisitions:

- significantly expanded our overall corporate size;
- significantly increased the breadth of the products and services that we offer; and
- expanded and strengthened our global footprint in the growing market for pharmaceutical research and development services.

These acquisitions, which include the acquisitions of NewLab BioQuality AG and MIR Preclinical Services in 2008, have been critical in our continuing mission to support our key pharmaceutical and biotechnology customers, who are increasingly seeking full service, global partners to whom they can outsource more of their preclinical research and development efforts. By some estimates, the outsourced drug development services market is approximately $5.0 billion annually. It is thought that this represents only 20-25% of all of the drug development work currently performed, and is expected to increase over time as outsourcing trends continue.

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In 2008, much of our focus has been dedicated towards our continued positioning of ourselves to take advantage of long-term opportunities to support our clients as they continue to outsource drug development services. The major elements of our capacity expansion program, which has been underway for three years and included the replacement of two of our larger existing PCS facilities with new, state-of-the-art facilities, are drawing to a close. We opened the first of the replacement sites in Massachusetts in 2007 and the second in Nevada in 2008. In addition, we opened a new PCS facility in China in late 2008, which we anticipate will be one of the first GLP-compliant facilities in China by the end of the first half of 2009, bolstering our efforts to become the partner of choice for our global pharmaceutical customers as they establish and expand research and development activities in China. We expect to open a new PCS facility in Sherbrooke (Canada) in the first quarter of 2009 in order to relieve capacity constraints at our Montreal facility. However, as a result of certain market factors which emerged in the second half of 2008 and negatively affected our sales growth, we evaluated our expansion plans and determined that we have sufficient capacity to accommodate our clients' current demand. Accordingly, we have delayed the expansion of our Ohio facility until 2010 when the industry will be better positioned to absorb additional capacity. In addition to our PCS capacity expansions, in 2008 we opened a new RMS facility in Maryland, in part to support the 10-year agreement with the National Cancer Institute to manage its research model colonies.

Research Models and Services (RMS). Charles River has been supplying research models to the drug development industry since 1947. With approximately 150 different strains, we continue to maintain our position as the global leader in the production and sale of research models, principally genetically and virally defined purpose-bred rats and mice. We also provide a variety of related services that are designed to assist our customers in supporting the use of research models in drug development. With multiple facilities located on three continents (North America, Europe and Asia (Japan)), we maintain production centers, including a total of approximately 180 barrier rooms or isolator facilities, strategically located near our customers. In 2008, RMS accounted for 49% of our total net sales and approximately 41% of our employees including approximately 128 science professionals with advanced scientific degrees.

Our RMS segment is comprised of (1) Research Models, (2) Research Model Services and (3) other related products and services.

Research Models. A significant portion of this business is comprised of the commercial production and sale of research models, principally purpose-bred rats, mice and other species for use by researchers. We provide our rodent models to numerous customers around the world, including most pharmaceutical companies, a broad range of biotechnology companies, many government agencies, and leading hospitals and academic institutions. We have approximately 23 production facilities located in 9 countries worldwide, which are strategically located to be in close proximity to our customers. Our research models include both standard strains and disease models such as those with compromised immune systems, which are increasingly in demand as early-stage research tools. The United States Food and Drug Administration (FDA) and foreign regulatory bodies typically require the safety and efficacy of new drug candidates be tested on research models like ours prior to testing in humans. As a result, our research models are an essential part of the drug discovery and development process.

Our rodent species have been and continue to be some of the most extensively used research models in the world, largely as a result of our continuous commitment to innovation and quality in the breeding process. Our research models are bred and maintained in controlled environments which are designed to ensure that the animals are free of specific viral and bacterial agents and other contaminants that can disrupt research operations and distort results. With our barrier room production capabilities, we are able to deliver consistently high-quality research models worldwide.

Our small research models include:

outbred animals, which are genetically heterogeneous;

inbred animals, which are genetically identical;

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hybrid animals, which are the offspring of two different inbred parents;

spontaneous mutant animals, which contain a naturally occurring genetic mutation (such as immune deficiency); and

other genetically modified research models, including knock-out models with one or more disabled genes and transgenic animals.

We also offer proprietary, disease-specific mouse and rat models used to find new treatments for diseases such as diabetes, obesity and cardiovascular and kidney disease. We are presently focusing our disease model program on four areas of research: cardiovascular, metabolic, renal and oncology which, in addition to providing overlapping disease modalities that support multiple uses of certain models, also permits us to concentrate on focused sales and marketing efforts.

In addition to our small research models, we also are a premier provider of high-quality purpose-bred, specific pathogen-free (SPF) or disease free, large research models to the biomedical research community, principally for use in their drug discovery and development studies.

Research Model Services. RMS also offers a variety of services, described below, designed to assist our customers in screening drug candidates faster. These services capitalize on the technologies and relationships developed through our research model business, and address the need among pharmaceutical and biotechnology companies to outsource the non-core aspects of their drug discovery activities. These services include those which are related to genetically defined research models for in-house research, as well as those services designed to implement efficacy screening protocols to improve the customer's drug evaluation process. We currently offer four major categories of research models services Genetically Engineered Models and Services, Consulting and Staffing Services, Research Animal Diagnostics, and Discovery and Imaging Services.

Genetically Engineered Models and Services (GEMS). In this area of our business, we assist our customers in validating, maintaining, improving, breeding and testing research models purchased or created by our customers for biomedical research activities. While the creation of a genetically engineered model (GEM) can be a critical scientific event, it is only the first step in the discovery process. Productive utilization of GEMs requires significant additional technical expertise. We provide breeding expertise, model characterization (including genotyping and phenotyping) and colony development, quarantine, embryo cryopreservation, embryo transfer and health and genetic monitoring. We provide these services to over 500 laboratories around the world from pharmaceutical and biotechnology companies to hospitals and universities and maintain more than 1,000 different types of naturally occurring or genetically engineered models for our customers.

Consulting and Staffing Services. Building upon our core capability as the leading provider of high-quality research models, we manage animal care operations (including recruitment, training, staffing and management services) on behalf of government and academic organizations, as well as commercial customers. Demand for our services results from the growing trend by these research institutions to outsource internal functions or activities that are not critical to the core scientific innovation process, or for which they do not maintain the necessary resources in-house. In addition, we believe that our expertise in animal care and facility operations enhances the productivity and quality of our customers' animal care and use programs.

Research Animal Diagnostics. We assist our customers in monitoring and analyzing the health and genetics of the research models used in their research protocols. We developed this capability internally by building upon the scientific foundation created by the diagnostic laboratory needs of our research model business. Depending upon a customer's needs, we may serve as its sole-source testing laboratory, or as an alternative source supporting its internal laboratory capabilities. We believe that the continued growth in model development and characterization and utilization of specific disease models and GEMs will drive our future growth as the reference laboratory of choice for health and genetic testing of laboratory animals.

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Discovery and Imaging Services. Augmenting our traditional model production and GEMS described above, we believe there are emerging opportunities to assist our customers in a variety of discovery and imaging areas, such as by speeding the development process by providing services that prepare models to be used in studies immediately upon arrival at the customer's facility, rather than requiring time and effort on the part of the customer to prepare the models. As a result of our veterinary medicine expertise, we are well positioned to provide such services, which include surgical procedures, feeding and aging, and biological and chemical modification. In addition, through our acquisition of MIR Preclinical Services, we now offer extensive *in vivo* imaging capabilities, as well as expertise in oncology and inflammation pharmacology. The Discovery and Imaging Services that we offer through our RMS business are complimentary to the Discovery Support services that we offer through our PCS business.

Other Related Research Model Products and Services. We also offer two other categories of products and services within RMS endotoxin and microbial detection products and vaccine support.

Endotoxin and Microbial Detection (EMD or In Vitro). Our EMD business provides non-animal, or *in vitro,* methods for lot release testing of medical devices and injectable drugs for endotoxin contamination. We are committed to being the leader in providing our customers with *in vitro* alternatives as these methods become scientifically validated and commercially feasible, and toward that goal we work with and support the European Center for Validation of Alternative Methods in these efforts. Endotoxin testing uses a processed extract from the blood of the horseshoe crab, known as limulus amebocyte lysate (LAL). The LAL test is the first and only major FDA-validated *in vitro* alternative to an animal model test. The process of extracting blood is generally not harmful to the crabs, which are subsequently returned to their natural ocean environment. Our *in vitro* technology business produces and distributes endotoxin testing kits, reagents, software, accessories, instruments and associated services to pharmaceutical and biotechnology companies worldwide. We are a market leader in endotoxin testing, which is used for FDA-required quality control testing of injectable drugs and medical devices, their components and the processes by which they are manufactured.

We have developed the next generation of the endotoxin testing platform, known as the Endosafe Portable Testing System (Endosafe®-PTS). The PTS is a portable endotoxin testing platform which allows rapid endotoxin testing in the central laboratory or in the field, affording researchers accurate and timely results. In 2006, we received FDA approval for the sale and marketing of the PTS system for FDA-required lot release endotoxin testing. The PTS can also be used for non-regulated applications, ranging from drug research and development to environmental monitoring. The PTS system has recently expanded into markets such as cell transplant and dialysis clinics, and, especially, nuclear pharmacies, where PTS is being adopted for lot release testing of nuclear medicines in response to pending FDA regulations. We are anticipating other opportunities developing as our customers react to the FDA's Process Analytical Technology (PAT) Initiative. In addition, over the next few years we look towards exploring other applications such as the environmental contaminant markets (pesticides and hazardous materials) and clinical diagnostics (infectious disease at point of care).

Vaccine Support. We are the global leader for the supply of specific pathogen-free, or SPF, chickens and fertile chicken eggs. SPF chicken embryos are used by animal health companies as self-contained "bioreactors" for the manufacture of live viruses. These viruses are used as a raw material primarily in poultry, as well as human vaccine, applications. The production of SPF eggs is done under biosecure conditions, similar in many ways to our research model production. We have a worldwide presence in North America with several SPF egg production facilities in the United States and contracted production capabilities in Hungary, and franchise operations in India, China and Australia. We also operate a specialized avian laboratory in the United States, which provides in-house testing quality control testing of the SPF flocks, offers testing services to vaccine companies and commercial poultry operations, and manufactures poultry diagnostics and bulk antigens for poultry vaccines.

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Preclinical Services (PCS). Our PCS customers are principally engaged in the discovery and development of new drugs, devices and therapies.

Discovery represents the earliest stages of research in the life sciences, directed at the identification, screening and selection of a lead compound for future drug development. Discovery activities typically last anywhere from 4-6 years in conventional pharmaceutical research and development timelines.

Development activities, which follow, and which can take up to seven years, are directed at demonstrating the *safety, tolerability* and *clinical efficacy* of the selected drug candidates. During the preclinical stage of the development process, a drug candidate is tested *in vitro* (typically on a cellular or subcellular level in a test tube or multi-well petri plate) and *in vivo* (in research models) to support planned or on-going human trials. With our focus on early-stage drug development support, we view clinical Phase I studies as a strategic component of our preclinical service offerings.

The development services portion of our PCS business enables our customers to outsource their critical, regulatory-required drug and toxicology disposition activities to us. The demand for these services was historically driven by preclinical development programs of biotechnology companies, which traditionally have been outsourced, and also by the selective outsourcing strategy of larger global pharmaceutical companies. The necessary significant investments in personnel, facilities and other capital resources required in order to efficiently conduct and perform these activities means that global pharmaceutical companies and biotechnology companies are frequently choosing to outsource their development activities, allowing them to focus on their core competencies of innovation and early drug discovery and, particularly for pharmaceutical companies, promotion and market distribution.

We are one of the two largest providers of preclinical services worldwide and offer particular expertise in the design, execution and reporting of general and specialty toxicology studies, especially those dealing with innovative therapies and biologicals. We currently provide preclinical services at multiple facilities located in the United States, Canada, Europe and Asia (China). We have recently completed significant expansions at our preclinical facilities in Massachusetts and Nevada, and are nearing completion of an expansion of capacity in Canada. In recognition of the current market conditions, we are postponing the expansion of our Ohio facility until such time as our available capacity is filled, which we target as 2010. Our PCS segment represented 51% of our total net sales in 2008 and employed 59% of our employees including approximately 450 science professionals with advanced scientific degrees.

We currently offer the following preclinical services, in which we include both *in vivo* and *in vitro* studies, supportive laboratory services, and strategic preclinical consulting and program management to support product development from inception to proof of concept.

Toxicology. Toxicology is one of our core preclinical competencies and a competitive strength. Once a lead molecule is selected, the stage of preclinical development begins where appropriate toxicology studies are conducted to support initial clinical trials. These studies are performed on animal models to understand the toxic effects that a compound has on an organism over a variety of doses and over various time periods, and focus on safety and potential harmful effects. Our toxicology services feature:

all the standard protocols for general toxicity testing (genotoxicity, safety pharmacology, acute, subacute, chronic toxicity and carcinogenicity potential) required for regulatory submissions supporting "first-in-human" to "first-on-the-market" strategies;

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expertise in specialty routes of administration and modes of administration (e.g., infusion, intravitreal administration, and inhalation), which are important not only for the testing of potential pharmaceuticals, but also for safety testing of medical devices, industrial chemicals, food additives, agrochemicals, biocides, nutraceuticals, animal health products and other materials;

market-leading expertise in the conduct and assessment of reproductive and developmental toxicology studies (in support of larger scale, human clinical trials);

services in important specialty areas such as ocular, bone, juvenile/neonatal, and immuno-toxicology as well as photobiology and dermal testing;

work in all major therapeutic areas;

study design and strategic advice to our clients based on our wealth of experience in support of drug development; and

a strong history of aiding our sponsors in reaching their regulatory or internal milestones for safety testing, including studies addressing stem cell therapies, DNA vaccines, recombinant proteins, standard small molecules and medical devices.

Our toxicology facilities operate in compliance with Good Laboratory Practices (GLPs) as required by the FDA as well as other international regulatory bodies. Our facilities are regularly inspected by U.S. and other GLP compliance monitoring authorities, as well as our own and our customers' Quality Assurance departments.

Pathology Services. In the drug development process, the ability to identify and characterize clinical and anatomic pathologic change is critical in determining the safety of a new compound. We employ a large number of highly trained pathologists who use state-of-the-art techniques to identify potential compound-related changes within tissues, fluids and cells, as well as at the molecular level. Pathology support is critical for regulatory driven safety studies, but also for specialized investigative studies, discovery support, and stand-alone immunohistochemistry evaluations for monoclonal antibodies. Key "go/no-go" decisions regarding continued product development are typically dependent on the identification, characterization and evaluation of gross and microscopic pathology findings we perform for our clients.

Bioanalysis, Pharmacokinetics, and Drug Metabolism. In support of preclinical drug safety testing, our customers are required to demonstrate ample drug exposure, stability in the collected sample, kinetics of their drug or compound in circulation, the presence of metabolites, and with recombinant proteins and peptides, the presence of anti-drug antibodies. We have scientific depth in the sophisticated analytical techniques required to satisfy these requirements for a number of drug classes (including oligonucleotide and inhibitory RNAs). In the event that the sample analysis for preclinical study support translates to opportunities to analyze clinical samples for the same drug once human testing begins, we have opportunities to capture the benefits of bridging preclinical bioanalysis with later clinical development. Once the analysis is complete, our scientists evaluate the data to provide information on the pharmacokinetics and/or toxicokinetics of the exposure to the drug, as well as complete evaluation of the distribution of the drug or metabolites by radio-labeled techniques. Pharmacokinetics refers to understanding what the body does to a drug or compound once administered, including the process by which the drug is absorbed, distributed in the body, metabolized, and excreted (ADME); toxicokinetics refers to the same understanding as applied to potential toxic substances. Our clients require these studies for the full preclinical assessment of the disposition of the drug, the results of which are used in the final preclinical safety evaluation of the compound.

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Discovery Support. At the earliest stages of lead compound identification, our scientists are engaged in evaluating the activity and efficacy of drug candidates in several important therapeutic areas, including:

- asthma (through our specialized disease model colonies);
- bone disease (using our state-of-the-art imaging and pathology capabilities);
- ophthalmology (using our models of neovascularization);
- general cardiovascular and device testing (using our surgical models); and
- early drug formulation and bioanalysis support and method development.

We also offer lead optimization strategies including early pharmacokinetic, metabolism, and toxicology support to help in early integrative drug selection criteria. The Discovery Support services that we offer through our PCS business are complimentary to the Discovery and Imaging Services that we offer through our RMS business.

Biopharmaceutical Services.

We provide specialized characterization, identity and safety testing of biologicals frequently outsourced by global pharmaceutical and biotechnology developers. Our laboratories in the United States, Germany (acquired in 2008 through our purchase of NewLab BioQuality AG), Scotland and Ireland provide timely, compliant molecular biology, virology, bioanalytical, immunochemistry, microbiology and related services. Our services in this area confirm that biological processes and the drug candidates produced are consistent, correctly defined, stable and essentially contaminant free. This type of testing is required by the FDA and other global regulatory authorities for our customers to obtain new drug approvals, to maintain government licensed manufacturing facilities and to release approved therapeutic products for patient treatment.

Our manufacturing services group grows and stores well-characterized early-stage client cell lines for later development or manufacture of therapeutic proteins and vaccines for clinical trials. We also collaborate with clients on process development, validation, manufacturing scale-up and biological testing.

Phase I Trials in Healthy, Normal and Special Populations

Phase I clinical trials are usually short duration studies conducted on a small number (20-100) of healthy human subjects (although special populations can be used) under highly controlled conditions. Testing is usually performed where trial participants can be closely monitored in a secure environment, such as at a clinic-type facility or hospital.

Our clinical services capabilities are centered around our premier Phase I clinic in Tacoma, Washington with a capacity of 250 beds. We focus our clinical services business on high-end clinical pharmacology studies in healthy participants. From a strategic perspective, we believe that our clinical services business benefits from pull-through from our preclinical and laboratory services (particularly with our biotechnology customers). Correspondingly, our preclinical and laboratory services businesses benefit from the presence of our Phase I clinical offerings as we can take advantage of enhanced economies of scale as well as "pull-down" from existing clinical customers.

We offer a wide range of Phase I clinical research services designed to move lead pharmaceutical candidates rapidly from preclinical development through Phase I pharmacokinetic tolerability and pharmacodynamic assessment to explore human pharmacology. We can conduct studies across a wide range of therapeutic areas, and have demonstrated experience in complex dose tolerance, radio-labeled, cardiac safety, pharmacokinetics, pharmacodynamics and bioavailability studies. In addition, we provide customers with high-end "first-in-human" studies for novel compounds, and expertise in complex drug-drug interaction studies. Participants at our clinics are evaluated through an intensive screening

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process to ensure study suitability. We employ clinical regulatory compliance staff to monitor the conduct and reporting of Phase I trials and to assure management that these trials are conducted in compliance with appropriate regulatory requirements.

Our Strategy

Our objective is to be the preferred strategic global partner for our clients in accelerating the search for drugs, devices and therapies. From discovery through proof of concept, our goal is to deliver a full portfolio of products and services for drug discovery and development (which are almost entirely mandated by law) and to partner with our clients to create the greatest value and strategic benefit to them. Our business is primarily driven by the continued growth of research and development spending by pharmaceutical and biotechnology companies, the federal government and academic institutions, and of outsourced services. According to reports by the Biomedical Industry Advisory Group, it takes 11 to 16 years and costs in the range of $180 million to $1.65 billion, with an average cost of approximately $900 million, to bring a new drug to market. Similarly, a separate report by the Pharmaceutical Research and Manufacturers of America estimate that it takes 10 to 15 years and costs in excess of $800 million to develop a drug ($1.2 billion for a biologic).

As the pressure to develop a strong pipeline of innovative new drugs increases, so does the pressure to contain costs, to implement research in multiple countries simultaneously and to identify, hire and retain a breadth of scientific and technical experts. These pressures are becoming more intense as patent expiries approach for many of our customers, leading them to increasingly rationalize their portfolios around therapeutic areas, streamline their operations, and look to outside partners to manage their non-core activities. In order to facilitate and speed their research (as well as to convert largely fixed costs into variable expenses), our pharmaceutical and biotechnology customers are increasingly making strategic decisions to outsource services which can be provided by high-quality full service providers like us. For instance, many of our larger customers particularly those in the pharmaceutical industry have announced plans to rationalize their workforce and facilities and/or increase outsourcing in order to concentrate on their core businesses and new product research and identification. These challenges are also leading to an increase in the role of procurement for cost control purposes, resulting in more bundled services and unique and deeper partnership arrangements from the perspective of both facility management and breadth of service. Over the past several years, we believe that the increase in these actions and the necessary growth of outsourcing is being driven by a unique confluence of events, including:

- the current outlook for drugs coming off patent protection and resulting threats from generic drug manufacturers, which are expected to affect a large percentage of these companies' existing revenues in the intermediate future (up to an estimated 30% of pharmaceutical companies' revenues by 2012);
- the reduction over the past decade in growth rate of drugs gaining approval;
- increased pressure to find drugs to cure critical diseases, many of which are complex and chronic and affect small patient populations, increasing risk and cost of development while segmenting and shrinking the patient populations from blockbusters to smaller, more specialized indications;
- continued productivity and cost containment pressures on the medical device, diagnostics and biopharmaceutical industries due in part to escalating global healthcare costs, increasing concentration of buying power attributable to larger payors and governments, while customers in those fields simultaneously need to manage increased financial focus on operating margins and returns;
- increasing globalization of drug development (particularly increased research and development activity in the India and China markets);
- heightened regulatory authority scrutiny worldwide, particularly concerning drug safety; and

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enhanced urgency to push the growing number of new compounds through the drug pipeline.

Outsourcing allows our customers to concentrate their internal expertise and resources on early drug discovery, while continuing to advance their most promising products through the development pipeline. This creates opportunities for companies such as ours who can help optimize our clients' programs and assist in accelerating the drug discovery and development process. Our strategy is to capitalize on these opportunities by continuing to build our portfolio of premium, value-added products and services through internal development and investment, augmented by strategic "bolt-on" transactions.

Our customers have faced a challenging market environment toward the end of 2008 and start of 2009. Among the factors that have affected them, we have seen the following have the most material impact:

Large pharmaceutical companies have intensified their cost-savings and efficiency actions, and have announced significant initiatives to improve their research and development productivity and enhance their drug pipelines. This focus has been manifested through reductions in infrastructure and by spending constraints. In the short term, we have seen large pharmaceuticals slow down their preclinical and Phase I studies in favor of their later-stage products as they reprioritize compound pipelines (focusing on the back-end of their pipelines in the near-term) and moderate their spending per drug candidate;

Biotechnology customers, particularly those that are cash-negative, have been highly focused on rationing their liquid assets in a challenging funding environment. In general, funding for biotechnology companies has been compromised by the current economic crisis;

Many customers are narrowing their pipeline focus to a smaller number of similar, high potential therapeutic areas where they may yield the greatest returns;

Many larger customers have diversified their technology platform bases and have focused their portfolios across biologics (therapeutic proteins, antibodies, RNAi and vaccines) while retaining their core expertise in small molecules;

Our customers generally have been focused on near-term cost constraints as they contend with the challenges of the global economic slowdown; and

Senior management turnover and structural realignment has resulted in some internal turmoil and slower decision-making in some of our larger customers while they finalize and roll-out their restructuring plans.

While the short term consequences of these actions have temporarily mitigated the outsourcing growth rate trends, we believe that in the mid-term there is no fundamental change in our clients' drug development activities and strategies, and in fact these changes will provide enhanced outsourcing opportunities going forward. In particular, we believe that as larger pharmaceutical companies become leaner and more efficient, they will also become more conservative in their staffing, lose experienced personnel, and generally focus on their core competencies of fundamental research and development and commercialization. This should lead to resumption of outsourcing as they assess their key internal priorities. Charles River is positioned to address our customers' future needs, as we can:

provide external expertise which may be too costly for our customers to build and/or maintain in-house;

partner with customers to allow them to compensate for recent capacity reductions;

provide flexible arrangements to better balance our clients' workload/staff requirements;

provide customized solutions by therapeutic area;

address our customers' demands for "non-core" but strategically important activities, such as *in vivo* biology, general and specialty toxicology and program management; and

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provide value to our customers through broad-based partnerships across the breadth of the Charles River portfolio.

In today's business environment, we believe there is a particular advantage in being a global, full service, high-quality provider of services throughout the drug discovery and development continuum. Many of our customers, especially large pharmaceutical companies, are attracted to Tier 1 contract research organizations with a full breadth of capabilities, and choose to establish preferred provider relationships with only a small number, which allows them to simplify their relationship management as well as access greater value from their outsourcing partner. Recent trends suggest that large pharmaceutical restructurings, with increased focus on key therapeutic areas, may favor larger contract research organizations who can present customers with the benefits of economies of scale and scope, global footprint and simplified communications and coordination. Those companies with critical mass and financial stability are likely to have an advantage, as we expect that customers will gravitate towards placing long-term studies with providers they can rely upon. We are focused on being recognized as a premier preferred provider and building broader and deeper long-term strategic partnerships with our customers. Accordingly, with many of our largest customers, we enter into global preferred provider agreements that span both segments of our business. And as the role of the procurement department of our customers in selecting outsourcing partners increases, we expect that global reach and the availability of value-added services will become essential, which will aid Charles River in capitalizing on future opportunities. In addition, in response to individual customer needs, we have also been flexible in entering into broad-based multi-year partnering arrangements, generally involving financial commitments from the customer, which tap into the broad array of physical and/or service resources that we provide, such as reserving dedicated space within existing facilities, building out space to a particular specification, working within our clients' infrastructure, or even establishing a new facility.

We intend to continue to broaden the scope of the products and services we provide across the drug development continuum primarily through internal development, which will be augmented, as needed, through focused acquisitions and alliances. Our approach to acquisitions is a disciplined one that seeks to target businesses that are a sound strategic fit and that offer the prospect of enhancing stockholder value. This strategy may include geographic expansion of existing core services, strengthening of one of our core services or the addition of a new product or service in a related or adjacent business. In 2008, we completed 6 acquisitions, ranging in size from $48.5 million to $1.4 million.

We believe that we are well positioned to exploit both existing and new outsourcing opportunities. As strategic outsourcing by our customers increases, we believe that our expertise in areas previously addressed by our customers' in-house capabilities allows us to provide a more flexible, efficient and cost-effective alternative for them. In short, because these products and services are the core of our business, we are able to build and maintain expertise and tap into economies of scale that are difficult for our customers to match with their internal capabilities.

We intend to focus our marketing efforts on, among other things, stimulating demand for further outsourcing across our entire portfolio. We believe that our ability to provide solutions that address all aspects of *in vivo* biology are increasingly attractive to our customers, and we are aligning our commercial activities to deliver flexible, customized programs designed to meet our client's global and site-specific needs, with an increasing emphasis on defining efficiency metrics and tangible value. In addition, as our customers narrow their focus toward specific therapeutic areas, we have increasingly aligned our services portfolio along therapeutic lines, particularly those subject to major research areas, such as oncology, metabolism, inflammation and cardiovascular. We have also focused on adding expertise in the biologics development areas. As a result of these collective efforts, we expect to be better positioned to gain market share by taking advantage of these trends, as well as broader based collaboration across the *in vivo* discovery to first-in-human continuum. In 2007 and 2008 we invested heavily in expanding our facilities capacity, which we expect to normalize beginning in 2009. Similarly,

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we are investing in our information technology systems and resources in order to better serve our customers, harmonize our data, and streamline our processes.

Customers

Our customers continue to consist primarily of all of the major pharmaceutical companies, many biotechnology companies, animal health, medical device, diagnostic and other life sciences companies, and leading hospitals, academic institutions, and government agencies. We have stable, long-term relationships with many of our customers. During 2008, no single commercial customer accounted for more than 5% of our total net sales.

For information regarding net sales and long-lived assets attributable to both of our business segments for the last three fiscal years, please see Note 10 included in the Notes to Consolidated Financial Statements included elsewhere in this Form 10-K. For information regarding net sales and long-lived assets attributable to operations in the United States, Europe, Canada, Japan and other countries for each of the last three fiscal years, please review Note 10 included in the Notes to Consolidated Financial Statements included elsewhere in this Form 10-K.

Sales, Marketing and Customer Support

We sell our products and services principally through our direct sales force and account management teams, the majority of whom work in North America, with the balance in Europe and the Asia-Pacific countries. Our primary promotional activities include organizing scientific symposia, publishing scientific papers, making presentations and participating at scientific conferences and trade shows in North America, Europe and Asia. We supplement these scientifically based marketing activities with trade advertising, direct mail and newsletters. In 2008, we launched our newly designed website. The direct sales force is supplemented by international distributors and agents for our products and services, particularly with respect to our EMD and Biopharmaceutical Services business.

Our internal marketing/product management teams support the field sales staff and account management teams while developing and implementing programs to create close working relationships with customers in the biomedical research industry. We maintain client/customer service, technical assistance and consulting service departments, which address both our customers' routine and more specialized needs. We frequently assist our customers in solving problems related to animal husbandry, health and genetics, biosecurity, preclinical and clinical study design, regulatory consulting, protocol development and other areas in which our expertise is widely recognized as a valuable resource by our customers.

Competition

Our strategy is to be a leader in each of the markets in which we participate. We compete in the marketplace on the basis of quality, reputation, responsiveness, pricing, innovation, breadth of therapeutic and scientific expertise, timeliness and availability, supported by our professional bench strength in animal science and toxicology, global capabilities and strategically located facilities worldwide. We are able to offer a unique portfolio through our broad array of both routine and specialized preclinical services, as well as a wide range of research models and research model services.

The competitive landscape for our two business segments varies.

For RMS, our main competitors include three smaller competitors in North America (each of whom have a global scope), and several smaller competitors in Europe and in Japan. Of our main U.S. competitors, two are privately held businesses and the third is a government funded, not-for-profit institution. We believe that none of our competitors in RMS has our comparable global reach, financial strength, breadth of product and services offerings, technical expertise or pharmaceutical and biotechnology industry relationships.

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As for PCS, we believe we are one of the two largest providers of preclinical services in the world, based on net service revenue. Our commercial competitors for preclinical services consist of both publicly held and privately owned companies, and it is estimated that the top five participants (including Charles River) account for approximately 50% of the global market (exclusive of clinical services), with the rest of the market remaining highly fragmented. Our PCS segment (including our Phase I business) also competes with in-house departments of pharmaceutical and biotechnology companies, universities and teaching hospitals. Independently, the Phase I clinical services market is highly fragmented, with many public and private participants sharing the bulk of the market augmented by a number of smaller, limited-service providers also providing capacity.

We believe that the barriers to entry in certain of our business units, particularly those which require substantial capital expenditures, trained and specialized personnel, and mandate GLP compliant practices, are generally high and present a significant impediment for new market participants.

Industry Support and Animal Welfare

One of our core values is a concern for and commitment to animal welfare. We have been in the forefront of animal welfare improvements in our industry, and continue to show our commitment with special recognition programs for employees who demonstrate an extraordinary commitment in this critical area of our business. We created our own Humane Care Initiative, which is directed by our Animal Welfare and Training Group. The goal of the initiative is to assure that we continue as a worldwide leader in the humane care of laboratory animals. Laboratory animals are an important resource that further our knowledge of living systems and contribute to the discovery of life-saving drugs and procedures. We work hand-in-hand with the scientific community to understand how living conditions, handling procedures and stress play an important role in the quality and efficiency of research. As animal caregivers and researchers, we are responsible to our clients and the public for the health and well being of the animals in our care.

We support a wide variety of organizations and individuals working to further animal welfare as well as the interests of the biomedical research community. We fund scholarships to laboratory animal training programs, provide financial support to non-profit institutions that educate the public about the benefits of animal research and provide awards and prizes to outstanding leaders in the laboratory animal medicine field.

Employees

As of December 27, 2008, we had approximately 9,000 employees including approximately 577 science professionals with advanced degrees, including approximately 143 D.V.M.s, 191 Ph.D.s and 13 M.D.s. Our employees are not unionized in the United States, although employees are unionized at some of our European facilities, consistent with local customs for our industry. Our annual satisfaction surveys indicate that we have an excellent relationship with our employees.

Backlog

Our backlog for our PCS business segment was approximately $310.7 million at December 27, 2008 as compared to $393 million at December 29, 2007. Our preclinical services are performed over varying durations, from short to extended periods of time, which may be as long as several years. We maintain an order backlog to track anticipated revenue from studies and projects that either have not started, but are anticipated to begin in the near future, or are in process and have not been completed. We only recognize a study or project in backlog after we have received written evidence of a customer's intention to proceed. We do not recognize verbal orders. Cancelled studies or projects are removed from backlog.

We believe our aggregate backlog as of any date is not necessarily a meaningful indicator of our future results for a variety of reasons. First, studies vary in duration (i.e., some studies that are

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included in 2008 backlog may be completed in 2009, while others may be completed in later years). Second, the scope of studies may change, which may either increase or decrease their value. Third, studies included in backlog may be subject to bonus or penalty payments. Fourth, studies may be terminated or delayed at any time by the client or regulatory authorities for a number of reasons, including the failure of a drug to satisfy safety and efficacy requirements or a sponsor making a strategic decision that a study or service is no longer necessary. Delayed contracts remain in our backlog until a determination of whether to continue, modify or cancel the study has been made. We cannot provide any assurance that we will be able to realize all or most of the net revenues included in backlog or estimate the portion to be filled in the current year.

Regulatory Matters

As our business operates in a number of distinct operating environments and in a variety of locations worldwide, we are subject to numerous, and sometimes overlapping, regulatory environments, as described below.

The Animal Welfare Act (AWA) governs the care and use of certain species of animals used for research. The United States Congress has passed legislation which excludes laboratory rats, mice and chickens used for research from regulation under the AWA. As a result, most of our United States small animal research model activities and our vaccine support services operations are not subject to regulation under the AWA. For regulated species, the AWA and attendant Animal Care regulations require producers and users of regulated species to provide veterinary care and to utilize specific husbandry practices such as cage size, shipping conditions, sanitation and, for certain species, environmental enrichment to assure the welfare of these animals. We comply with licensing and registration requirement standards set by the United States Department of Agriculture (USDA) for the care and use of regulated species. Our animal production facilities and preclinical facilities in the U.S. are accredited by the Association for Assessment and Accreditation of Laboratory Animal Care International (AAALAC), a private, nonprofit, international organization that promotes the humane treatment of animals in science through voluntary accreditation and assessment programs. AAALAC covers all species of laboratory animals, including rats, mice and birds. Our preclinical business is also generally regulated by the USDA.

Our import and export of animals in support of several of our business units as well as our operations in foreign countries are subject to a variety of national, regional, and local laws and regulations, which establish the standards for the humane treatment, care and handling of animals by dealers and research facilities. We maintain the necessary certificates, licenses, detailed standard operating procedures and other documentation required to comply with applicable regulations for the humane treatment of the animals in our custody at our locations.

Our PCS business conducts nonclinical laboratory safety studies intended to support the registration or licensing of our clients' products throughout the world. A minor part of our RMS business also conducts similar studies for our clients. The conduct of these studies must comply with national statutory or regulatory requirements for Good Laboratory Practice (GLP). GLP regulations describe a quality system concerned with the organizational process and the conditions under which nonclinical laboratory studies are planned, performed, monitored, recorded, archived and reported. GLP compliance is required by such regulatory agencies as the FDA, United States Environmental Protection Agency, European Agency for the Evaluation of Medicinal Products, Medicines and Healthcare Products Regulatory Agency (MHRA) in the United Kingdom, Health Canada, State Food and Drug Administration of the Peoples' Republic of China, and the Japanese Ministry of Health and Welfare. GLP requirements are significantly harmonized throughout the world and our laboratories are capable of conducting studies in compliance with all appropriate requirements. To assure our compliance obligations, we have established quality assurance units (QAU) in each of our nonclinical laboratories. The QAUs operate independently from those individuals that direct and conduct studies and monitor each study to assure management that the facilities, equipment, personnel, methods, practices, records, and controls are in compliance with GLP. Our laboratory managers use the results of

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QAU monitoring as part of a continuous process improvement program to assure our nonclinical studies meet client and regulatory expectations for quality and integrity.

Our PCS business also conducts human Phase I clinical trials and provides services in support of our clients' registration or licensing applications. Human clinical trials are conducted in a progressive fashion beginning with Phase I, and in the case of approved drugs, continued through Phase IV trials. Phase I studies are the initial human clinical trials and are conducted with a small number of subjects under highly controlled conditions. These clinical trials and services are performed in accordance with the International Conference on Harmonization of Technical Requirements for Registration of Pharmaceuticals for Human Use Good Clinical Practice Consolidated Guidance and in compliance with regulations governing the conduct of clinical investigations and the protection of human clinical trial subjects. In the United States, these trials and services must comply with FDA regulations and in Europe our clinical trials and services must comply with the clinical trials directive of the European Union. Neither FDA regulations nor the clinical trials directive requires a quality assurance program; however, our Phase I facilities have established quality assurance units that monitor the conduct and reporting of Phase I trials to assure that these trials are conducted in compliance with appropriate regulatory requirements.

Our manufacturing business produces endotoxin test kits, reagents, cell banks used in research and biopharmaceutical production and vaccine support products. Additionally, several of our laboratories conduct identity, stability and potency testing in support of our clients' manufacturing programs. These activities are subject to regulation by the FDA and other national regulatory agencies under their respective Good Manufacturing Practice (GMP) regulations. We are subject to inspection on a routine basis for compliance with these regulations. These regulations require that we manufacture our products or perform testing in a prescribed manner with respect to GMP compliance, and maintain records of, our manufacturing, testing and control activities. We also maintain an Establishment License with USDA's Center for Veterinary Biologics (CVB) that covers certain of our sites which manufacture antigens used in a licensed diagnostic kit for rodents or particular to our vaccine support business which manufacturer USDA licensed antigens, antibodies, and viruses that are sold to clients for use in the manufacturing of their own USDA licensed products. Our vaccine support business also manufactures and markets two USDA licensed products that are considered final use products (Mycoplasma Gallisepticum Antigen and Mycoplasma Synoviae Antigen), and sites involved in the manufacture of these articles are subject to regular inspection by USDA/CVB.

All of our sites are also subject to licensing and regulation under national, regional and local laws relating to the surface and air transportation of laboratory specimens, the handling, storage and disposal of laboratory specimens, hazardous waste and radioactive materials, and the safety and health of laboratory employees. Although we believe we are currently in compliance in all material respects with such national, regional and local laws (which include the USDA, the standards set by the International Air Transport Association, and European oversight agencies), failure to comply could subject us to denial of the right to conduct business, fines, criminal penalties and other enforcement actions.

To ensure that all business sectors comply with applicable statutory and regulatory requirements and satisfy our client expectations for quality and regulatory compliance, we have established a corporate regulatory affairs and compliance organization that oversees our corporate quality system and all quality assurance functions within the Company, headed by our Corporate Vice President for Regulatory Affairs and Compliance.

Intellectual Property

We have developed and implemented computer software and technically derived procedures and products intended to maximize the quality and effectiveness of our services. Although our intellectual property rights are valuable to our success, we believe that such factors as the technical expertise, proprietary know-how, ability and experience of our professionals are more important, and that, overall,

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these technological capabilities provide significant benefits to our clients. Where we consider it appropriate, steps are taken to protect our know-how through confidentiality agreements and protection through registration of title or use. In addition, we in-license technology and products from other companies where it enhances both our product and services business. In the future, in-licensing may become a larger initiative to enhancing our offerings, particularly as we focus on therapeutic area expertise. With the exception of technology related to our *in vitro* testing business, including the Endosafe-PTS, we have no patents, trademarks, licenses, franchises or concessions which are material and upon which any of the products or services we offer are dependent.

Corporate Governance

We are committed to operating our business with integrity and accountability. We strive to meet or exceed all of the corporate governance standards established by the New York Stock Exchange, the Securities and Exchange Commission, and the Federal government as implemented by the Sarbanes-Oxley Act of 2002. Nine of the ten members of our Board of Directors are independent and have no significant financial, business or personal ties to the Company or management and all of our Board committees are composed entirely of independent directors. The Board adheres to Corporate Governance Guidelines and a Code of Business Conduct and Ethics which has been communicated to employees and posted on our website. We are diligent in complying with established accounting principles and are committed to providing financial information that is transparent, timely and accurate. We have a Related Person Transactions Policy designed to promote the timely identification of such transactions and to ensure we give appropriate consideration to any real or perceived conflicts in our commercial arrangements. We have a global process through which employees, either directly or anonymously, can notify management (and the Audit Committee of the Board of Directors) of alleged accounting and auditing concerns or violations including fraud. Our internal Disclosure Committee meets regularly and operates pursuant to formal disclosure procedures and guidelines which help to ensure that our public disclosures are accurate and timely. Copies of our Corporate Governance Guidelines, Code of Business Conduct and Ethics and Related Person Transactions Policy are available on our website at www.criver.com under the "Investor Relations Corporate Governance" caption.

Item 1A. Risk Factors

Risks Related to Our Business and Industry

Set forth below and elsewhere in this Form 10-K and in other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this Form 10-K. We note that factors set forth below, individually or in the aggregate, may cause our actual results to differ materially from expected and historical results. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties.

The outsourcing trend in the preclinical and clinical stages of drug discovery and development may decrease, which could slow our growth.

Over the past several years, some areas of our businesses have grown significantly as a result of the increase in pharmaceutical and biotechnology companies outsourcing their preclinical and clinical research support activities. While industry analysts expect the outsourcing trend to continue for the next several years, a decrease in preclinical and/or clinical outsourcing activity could result in a diminished growth rate in the sales of one or more of our expected higher-growth areas and adversely affect our financial condition and results of operations. For additional discussion of the factors that we believe have recently been influencing outsourcing demand from our customers, please see the section entitled "Our Strategy" included elsewhere in the Form 10-K. Furthermore, our customer contracts are generally terminable on little or no notice. Termination of a large contract or multiple contracts could adversely affect our sales and profitability. Our operations and financial results could be significantly affected by these risks.

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A reduction in research and development budgets at pharmaceutical and biotechnology companies may adversely affect our business.

Our customers include researchers at pharmaceutical and biotechnology companies. Our ability to continue to grow and win new business is dependent in large part upon the ability and willingness of the pharmaceutical and biotechnology industries to continue to spend on compounds in the preclinical phase of research and development and to outsource the products and services we provide. Fluctuations in the expenditure amounts in each phase of the research and development budgets of these researchers and their organizations could have a significant effect on the demand for our products and services. Research and development budgets fluctuate due to changes in available resources, mergers of pharmaceutical and biotechnology companies, spending priorities and institutional budgetary policies. Our business could be adversely affected by any significant decrease in life sciences research and development expenditures by pharmaceutical and biotechnology companies, as well as by academic institutions, government laboratories or private foundations. In particular, recent studies have indicated that a majority of academic researchers are anticipating reductions in their budgets. Similarly, economic factors and industry trends that affect our clients in these industries, including funding for biotechnology companies, which have suffered during the economic downturn in 2008/2009, also affect their research and development budgets and, consequentially, our business as well. The economic downturn has also negatively affected us to the extent that the research and development budgets at our pharmaceutical customers have recently slowed down their preclinical and Phase I studies in favor of their later-stage products as they reprioritize compound pipelines (focusing on the back-end of their pipelines in the near-term) and moderate their spending per drug candidate. For additional discussion of the factors that we believe have recently been influencing outsourcing demand from our customers, please see the section entitled "Our Strategy" included elsewhere in the Form 10-K.

A reduction or delay in government funding of research and development may adversely affect our business.

A portion of net sales in our RMS segment is derived from customers at academic institutions and research laboratories whose funding is partially dependent on both the level and timing of funding from government sources, such as the U.S. National Institutes of Health (NIH) and similar domestic and international agencies. Government funding of research and development is subject to the political process, which is inherently unpredictable. Our sales may be adversely affected if our customers delay purchases as a result of uncertainties surrounding the approval of government budget proposals. Also, government proposals to reduce or eliminate budgetary deficits have sometimes included reduced allocations to the NIH and other government agencies that fund research and development activities. Although recent reports indicate that the new administration's stimulus package includes a substantial increase in NIH funding for 2009, NIH funding has remained fairly flat in recent years and a reduction in government funding for the NIH or other government research agencies could adversely affect our business and our financial results.

Changes in government regulation or in practices relating to the pharmaceutical or biotechnological industries, including potential health care reform, could decrease the need for the services we provide.

Governmental agencies throughout the world, but particularly in the United States, strictly regulate the drug development process. Our business involves helping pharmaceutical and biotechnology companies, among others, navigate the regulatory drug approval process. Accordingly, many regulations, and often new regulations, are expected to result in higher regulatory standards and often additional revenues for companies that service these industries. However, some changes in regulations, such as a relaxation in regulatory requirements or the introduction of simplified drug approval procedures, or an increase in regulatory requirements that we have difficulty satisfying or that make our services less competitive, could eliminate or substantially reduce the demand for our services. In addition, if regulatory authorities were to mandate a significant reduction in safety testing procedures which utilize laboratory animals (as has been advocated by certain groups), certain segments of our business could be materially adversely affected.

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In recent years the U.S. Congress and state legislatures have considered various types of health care reform in order to control growing health care costs. We are unable to predict what legislative proposals will be adopted in the future, if any. Similar reform movements have occurred in Europe and Asia.

Implementation of health care reform legislation that contains costs could limit the profits that can be made from the development of new drugs. This could adversely affect research and development expenditures by pharmaceutical and biotechnology companies, which could in turn decrease the business opportunities available to us both in the United States and abroad. In addition, new laws or regulations may create a risk of liability, increase our costs or limit our service offerings. Furthermore, if health insurers were to change their practices with respect to reimbursements for pharmaceutical products, our customers may spend less, or reduce their growth in spending on research and development.

Our standard customer agreements contain customer-determined termination and service reduction provisions, which may result in less contract revenue than we anticipate.

Generally, our agreements with our customers provide that the customers can terminate the agreements or reduce the scope of services under the agreements with little or no notice. Customers may elect to terminate their agreements with us for various reasons, including: the products being tested fail to satisfy safety requirements; unexpected or undesired study results; production problems resulting in shortages of the drug being tested; the customer's decision to forego or terminate a particular study; or the loss of funding for the particular research study. If a customer terminates a contract with us, we are entitled under the terms of the contract to receive revenue earned to date as well as certain other costs and, in some cases, penalties. Cancellation of a large contract or proximate cancellation of multiple contracts could materially adversely affect our business (particularly our PCS segment) and, therefore, may adversely affect our operating results.

Many of our contracts are fixed price and may be delayed or terminated or reduced in scope for reasons beyond our control, or we may under-price or overrun cost estimates with these contracts, potentially resulting in financial losses.

Many of our contracts provide for services on a fixed price or fee-for-service with a cap basis and, accordingly, we bear the financial risk if we initially under-price our contracts or otherwise overrun our cost estimates. In addition, these contracts may be terminated or reduced in scope either immediately or upon notice. Cancellations may occur for a variety of reasons, and often at the discretion of the customer. The loss, reduction in scope or delay of a large contract or the loss or delay of multiple contracts could materially adversely affect our business, although our contracts frequently entitle us to receive the costs of winding down the terminated projects, as well as all fees earned by us up to the time of termination. Some contracts also entitle us to a termination fee.

Contaminations in our animal populations can damage our inventory, harm our reputation for contaminant-free production, result in decreased sales and cause us to incur additional costs.

Our research models and fertile chicken eggs must be free of certain adventitious, infectious agents such as certain viruses and bacteria because the presence of these contaminants can distort or compromise the quality of research results and could adversely impact human or animal health. The presence of these infectious agents in our animal production facilities and certain service operations could disrupt our contaminant-free research model and fertile egg production as well as our animal services businesses including GEMS, harm our reputation for contaminant-free production and result in decreased sales.

Contaminations typically require cleaning up, renovating, disinfecting, retesting and restarting production or services. Such clean-ups result in inventory loss, clean-up and start-up costs, and reduced sales as a result of lost customer orders and credits for prior shipments. In addition to microbiological

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contaminations, the potential for genetic mix-ups or mismatings also exists and may require the restarting of the applicable colonies. While this does not require the complete clean-up, renovation and disinfection of the barrier room, it would likely result in inventory loss, additional start-up costs and possibly reduced sales. In addition, contaminations expose us to risks that customers will request compensation for damages in excess of our contractual indemnification requirements. There also exists a risk that contaminations from models that we produce may affect our customer's facilities, with similar impact to them. In some cases, we may produce or import animals carrying infectious agents capable of causing disease in man; and in the case of such a contamination or undiagnosed infection, there could be a possible risk of human exposure and infection.

All such contaminations described above are unanticipated and difficult to predict and could adversely impact our financial results. We have made significant capital expenditures designed to strengthen our biosecurity and have significantly improved our operating procedures to protect against such contaminations; however, contaminations may still occur.

Our business is subject to risks relating to operating internationally.

A significant part of our net sales is derived from operations outside the United States. Our international revenues, which include revenues from our non-U.S. subsidiaries, have represented approximately one-half our total net sales in recent years. We expect that international revenues will continue to account for a significant percentage of our revenues for the foreseeable future. There are a number of risks associated with our international business, including:

- foreign currencies we receive for sales and which we record as expenses outside the United States could be subject to unfavorable exchange rates with the U.S. dollar and reduce the amount of revenue (and increase the amount of expenses) that we recognize and cause fluctuations in reported financial results;

- certain contracts, particularly in Canada, are frequently denominated in currencies other than the currency in which we incur expenses related to those contracts and where expenses are incurred in currencies other than those in which contracts are priced, fluctuations in the relative value of those currencies could have a material adverse effect on our results of operations;

- general economic and political conditions in the markets in which we operate;

- potential international conflicts, including terrorist acts;

- potential trade restrictions, exchange controls and legal restrictions on the repatriation of funds into the United States;

- difficulties and costs associated with staffing and managing foreign operations, including risks of violations of local laws or the U.S. Foreign Corrupt Practices Act by employees overseas or the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions;

- unexpected changes in regulatory requirements;

- the difficulties of compliance with a wide variety of foreign laws and regulations;

- unfavorable labor regulations in foreign jurisdictions;

longer accounts receivable cycles in certain foreign countries; and

import and export licensing requirements.

Upgrading and integrating our business systems could result in implementation issues and business disruptions.

We currently are engaged in a project to replace many of our numerous legacy business systems at our different sites globally with an enterprise wide, integrated enterprise resource planning (ERP)

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system. The process of planning and preparing for such an integrated, wide-scale implementation is extremely complex and we are required to address a number of challenges including data conversion, system cutover and user training. Problems in any of these areas could cause operational problems during implementation including delayed shipments, missed sales, billing and accounting errors and other operational issues. There have been numerous, well-publicized instances of companies experiencing difficulties with the implementation of ERP systems which resulted in negative business consequences.

Negative attention from special interest groups may impair our business.

The products and services which we provide our customers are essential to the drug discovery and development process, and are almost universally mandated by law. Notwithstanding, certain special interest groups categorically object to the use of animals for valid research purposes. Historically, our core research model activities with rats, mice and other rodents have not been the subject of significant animal rights media attention. However, research activities with animals have been the subject of adverse attention, impacting the industry. This has included on-site demonstrations near facilities operated by us. Any negative attention, threats or acts of vandalism directed against our animal research activities in the future could impair our ability to operate our business efficiently.

Several of our product and service offerings are dependent on a limited source of supply, which if interrupted could adversely affect our business.

We depend on a limited international source of supply of large animal models required in our product and service offerings. Disruptions to their continued supply may arise from health problems, export or import restrictions or embargoes, foreign government or economic instability, severe weather conditions, increased competition amongst suppliers for models, disruptions to the air travel system or other normal-course or unanticipated events. Any disruption of supply could harm our business if we cannot remove the disruption or are unable to secure an alternative or secondary supply source on comparable commercial terms.

Any failure by us to comply with applicable regulations and related guidance could harm our reputation and operating results.

Any failure on our part to comply with applicable regulations could result in the termination of ongoing research or the disqualification of data for submission to regulatory authorities. This could harm our reputation, our prospects for future work and our operating results. For example, if we were to fail to verify that informed consent is obtained from participants in connection with a particular Phase I clinical trial, the data collected from that trial could be disqualified and we might be required to redo the trial at no further cost to our customer, but at substantial cost to us. Furthermore, the issuance of a notice of observations or a warning from the FDA based on a finding of a material violation by us of good clinical practice, good laboratory practice or current good manufacturing practice requirements could materially and adversely affect us.

In addition, regulations and guidance worldwide concerning the production and use of laboratory animals for research purposes continues to be updated. Notably, there has been a recent updating of guidance in Europe that will be implemented over a period of several years on a country-by-country basis. Similarly, guidance has been and continues to be developed for other areas that impact the biomedical research community including transportation and the use of disinfectants. In the United States, an updating of guidance used by the National Institutes of Health and by certain oversight agencies has been recently funded, and it is expected that over the next 3 years, standards will be updated for the care and use of laboratory animals in all aspects of our US business units. These new guidelines could cause us increased costs attributable to additional facilities, the need to add personnel to address new processes, as well as increased administrative burden, and the upgrading of existing facilities.

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The drug discovery and development services industry is highly competitive.

The drug discovery and development services industry is highly competitive. We often compete for business not only with other drug discovery and development companies, but also with internal discovery and development departments within our larger clients, who may have greater resources than ours. We also compete with universities and teaching hospitals. We compete on a variety of factors, including:

- reputation for on-time quality performance;
- reputation for regulatory compliance;
- expertise and experience in specific areas;
- scope and breadth of service and product offerings;
- broad geographic availability;
- price/value;
- technological expertise and efficient drug development processes;
- quality of facilities;
- financial stability;
- size;
- ability to acquire, process, analyze and report data in an accurate manner; and
- ability to manage Phase I clinical trials both domestically and internationally.

If we do not compete successfully, our business will suffer. Increased competition might lead to price and other concessions that might adversely affect our operating results. The drug discovery and development services industry has continued to see a trend towards consolidation, particularly among the biotechnology companies, who are targets for each other and for larger pharmaceutical companies (although recent trends in late 2008 and early 2009 may signal increased merger activity between larger pharmaceutical companies themselves). If this trend continues, it is likely to produce more competition among the larger companies and contract research organizations generally, with respect to both clients and acquisition candidates. In addition, while there are substantial barriers to entry for large, global competitors with broad-based services, small, specialized entities considering entering the contract research organization industry will continue to find lower barriers to entry, and private equity firms may determine that there are opportunities in acquiring and rolling up these companies, thus further increasing possible competition. Furthermore, in recent years both Charles River and our competitors, particularly in the preclinical services area, have been investing in capital projects to increase capacity. An ongoing challenge for all participants is balancing capacity growth and market demand. If capacity has been increased too much, pressure to lower prices or to take on lower-margin studies and projects may occur. These competitive pressures may affect the attractiveness of our services and could adversely affect our financial results.

We could be adversely affected by tax law changes in Canada and the United Kingdom.

We have substantial operations in Canada and the United Kingdom which currently benefit from favorable corporate tax arrangements. We receive substantial tax credits in Canada from both the Canadian federal and Quebec governments and benefits from tax credits and accelerated tax depreciation allowances in the United Kingdom. Any reduction in the availability or amount of these tax credits or allowances would be likely to have a material adverse effect on profits, cash flow and our effective tax rate.

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Impairment of goodwill may adversely impact future results of operations.

We have intangible assets, including goodwill and other identifiable and indefinite-lived acquired intangibles on our balance sheet due to our acquisitions of businesses. The initial identification and valuation of these intangible assets and the determination of the estimated useful lives at the time of acquisition involve use of management judgments and estimates. These estimates are based on, among other factors, input from accredited valuation consultants, reviews of projected future income cash flows and statutory regulations. The use of alternative estimates and assumptions might have increased or decreased the estimated fair value of our goodwill and other intangible assets that could potentially result in a different impact to our results of operations.

We perform an annual impairment analysis of goodwill to determine if impairment exists. The goodwill impairment analysis is a two-step process. The first step is used to identify potential impairment and involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. Fair value is determined by using a weighted combination of a market-based approach and an income approach, as this combination is deemed to be the most indicative of our fair value in an orderly transaction between market participants. Under the market-based approach, we utilize information about our Company as well as publicly available industry information to determine earnings multiples and sales multiples that are used to value our reporting units. Under the income approach, we determine fair value based on the estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital which reflects the overall level of inherent risk of the reporting unit and the rate of return an outside investor would expect to earn. Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates, profit margin percentages, discount rates, perpetuity growth rates, future capital expenditures and future market conditions, among others. Our projections are based on an internal strategic review. Key assumptions, strategies, opportunities and risks from this strategic review along with a market evaluation are the basis for our assessment. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is not considered to be impaired. However, if the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment.

The second step of the goodwill impairment process involves the calculation of an implied fair value of goodwill for each reporting unit for which step one indicated impairment. The implied fair value of goodwill is determined similar to how goodwill is calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit as calculated in step one, over the estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. In determining the fair value of assets we utilize appraisals for the fair value of property and equipment and valuations of certain intangible assets, including customer relationships.

Our annual goodwill impairment assessment has historically been completed at the beginning of the fourth quarter. Based on our initial assessment (step one) for 2008, the fair value of our business units exceeded their carrying value therefore our goodwill was not impaired. As economic conditions worsened late in the fourth quarter and our business performance and outlook was not as strong as anticipated coupled with a decrease in our market capitalization, management determined that circumstances had changed enough to trigger another goodwill impairment test as of December 27, 2008. Our analysis resulted in the determination that the fair value our PCS business was less than its carrying value. The second step of the goodwill impairment test involved us calculating the implied goodwill for the PCS business. The carrying value of the goodwill assigned to the PCS business exceeded the implied fair value of goodwill resulting in a goodwill impairment of $700 million.

Goodwill will not be amortized, but will be reviewed for impairment at least annually. The results of this year's impairment test are as of a point in time. If the future growth and operating results of our business are not as strong as anticipated and/or our market capitalization declines, this could

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impact the assumptions used in calculating the fair value in subsequent years. To the extent goodwill is impaired, its carrying value will be written down to its implied fair value and a charge will be made to our earnings. Such an impairment charge could materially and adversely affect our operating results and financial condition. As of December 27, 2008, we had recorded goodwill and other intangibles of $593.7 million in the consolidated balance sheet.

Contract research services create a risk of liability.

As a contract research organization we face a range of potential liabilities which may include:

errors or omissions in reporting of study detail in preclinical or Phase I clinical studies that may lead to inaccurate reports, which may potentially advance studies absent the necessary support or inhibit studies from proceeding to the next level of testing;

litigation risk, including resulting from our errors or omissions, associated with the possibility that the drugs/compounds of our clients that were included in drug development trials we participated in may cause illness, personal injury or have other negative side effects to clinical study participants or other persons (including death);

general risks associated with operating a Phase I clinical business, including negative consequences from the administration of drugs to clinical trial participants or the professional malpractice of Phase I medical care providers;

risks associated with our possible failure to properly care for our customers' property, such as research models and samples, study compounds, records, work in progress, other archived materials, or goods and materials in transit, while in our possession;

risks that models in our breeding facilities or in facilities that we run may be infected with diseases that may be harmful and even lethal to themselves or humans despite preventive measures contained in our company policies for the quarantine and handling of imported animals; and

errors and omissions during a trial that may undermine the usefulness of a trial or data from the trial.

We attempt to mitigate these risks through a variety of methods. Nonetheless, it is impossible to completely eradicate such risks.

In our RMS business, we mitigate these risks to the best of our abilities through our regimen of animal testing, quarantine, and veterinary staff vigilance, through which we seek to control the exposure of animal related disease or infections.

In our PCS business, we attempt to reduce these risks by contract provisions entitling us to be indemnified or entitling us to a limitation of liability; insurance maintained by our clients, investigators, and by us; and various regulatory requirements we must follow in connection with our business.

In both our RMS and PCS businesses, contractual indemnifications generally do not protect us against liability arising from certain of our own actions, such as negligence or misconduct. We could be materially and adversely affected if we were required to pay damages or bear the costs of defending any claim which is not covered by a contractual indemnification provision or in the event that a party who must indemnify us does not fulfill its indemnification obligations or which is beyond the level of our insurance coverage. Furthermore, there can be no assurance that we will be able to maintain such insurance coverage on terms acceptable to us.

We may be unable to build out our facilities as anticipated.

To support our customers' demand for drug discovery and development services, including increased strategic focus on outsourcing services and programs, we had engaged in a substantial capacity expansion program over the past two years with $227 million spent on capital expenditures in

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2007 and $197 million in 2008. We estimated $100-$120 million allocated for capital expenditures in 2009, as major expansions complete and capacity comes on-line. Included in our 2009 capital plan are the following: continuing fit-out work at our new PCS facility in Nevada, dedicated space initiatives at our new PCS facility in Massachusetts, expansions at our Canada and Scotland PCS facilities, and the remaining work for completing the construction of our new PCS facility in China. We cannot assure you that any or all of these facilities, or any particular phase of such facilities, will be constructed on the anticipated timetable or on budget. Any material delay in bringing these facilities on-line, or substantial increase in costs to complete these facilities, could materially and adversely affect us. In addition, the costs of these capacity expansion programs may have an adverse impact on our operating margins, particularly within our PCS business.

If we are unable to attract suitable participants for our Phase I clinical trials, our business might suffer.

The Phase I clinical research studies we run rely upon the ready accessibility and willing participation of subjects. Participants generally include people from the communities in which the studies are conducted, which such communities to date have provided a substantial pool of potential subjects for research studies. Our Phase I clinical research activities could be adversely affected if we were unable to attract suitable and willing participants on a consistent basis.

New technologies may be developed, validated and increasingly used in biomedical research that could reduce demand for some of our products and services.

For many years, groups within the scientific and research communities have attempted to develop models, methods and systems that would replace or supplement the use of living animals as test subjects in biomedical research. Some companies have developed techniques in these areas, including vaccine development, that may have scientific merit. In addition, technological improvements to existing or new processes, such as imaging technology, could result in a refinement in the number of animal research models necessary to conduct the required research. It is our strategy to participate in some fashion with any non-animal test method or other method that reduces the need for animal research models as it becomes validated as a research model alternative or adjunct in our markets. For instance, we acquired imaging capabilities in 2008 through our acquisition of MIR Preclinical. However, we generally may not be successful in commercializing these methods if developed, and sales or profits from these methods may not offset reduced sales or profits from research models. Alternative research methods could decrease the need for research models, and we may not be able to develop new products effectively or in a timely manner to replace any lost sales.

The drug discovery and development industry has a history of patent and other intellectual property litigation, and we might be involved in costly intellectual property lawsuits.

The drug discovery and development industry has a history of patent and other intellectual property litigation and these lawsuits will likely continue. Accordingly, we face potential patent infringement suits by companies that have patents for similar products and methods used in business or other suits alleging infringement of their intellectual property rights. Legal proceedings relating to intellectual property could be expensive, take significant time and divert management's attention from other business concerns, whether we win or lose. If we do not prevail in an infringement lawsuit brought against us, we might have to pay substantial damages, including treble damages, and we could be required to stop the infringing activity or obtain a license to use technology on unfavorable terms.

We may not be able to successfully develop and market new services.

We may seek to develop and market new services that complement or expand our existing business or service offerings. If we are unable to develop new services and/or create demand for those newly developed services, our future business, results of operations, financial condition, and cash flows could be adversely affected.

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Our debt level could adversely affect our business and growth prospects.

At December 27, 2008, we had approximately $575.8 million of debt. This debt could have significant adverse effects on our business, including making it more difficult for us to obtain additional financing on favorable terms; requiring us to dedicate a substantial portion of our cash flows from operations to the repayment of debt and the interest on this debt; limiting our ability to capitalize on significant business opportunities; and making us more vulnerable to rising interest rates. For additional information regarding our debt, please see Note 4 included in the Notes to Consolidated Financial Statements elsewhere in this Form 10-K.

If we are not successful in selecting and integrating the businesses and technologies we acquire, our business may suffer.

During the past seven years, we have expanded our business through several acquisitions. We plan to continue to acquire businesses and technologies and form strategic alliances. However, businesses and technologies may not be available on terms and conditions we find acceptable. We risk spending time and money investigating and negotiating with potential acquisition or alliance partners, but not completing transactions. For instance, in 2008, we expensed over $1.3 million for costs incurred for potential deals that we decided to abandon prior to signing definitive agreements.

Even if completed, acquisitions and alliances involve numerous risks which may include:

- difficulties and expenses incurred in assimilating and integrating operations, services, products or technologies;
- challenges with developing and operating new businesses, including diversion of management's attention from other business concerns;
- potential losses resulting from undiscovered liabilities of acquired companies that are not covered by the indemnification we may obtain from the seller;
- acquisitions could be dilutive to earnings, or in the event of acquisitions made through the issuance of our common stock to the shareholders of the acquired company, dilutive to the percentage of ownership of our existing stockholders;
- loss of key employees of the acquired companies;
- risks of not being able to overcome differences in foreign business practices, customs and importation regulations, language and other cultural barriers in connection with the acquisition of foreign companies;
- the presence or absence of adequate internal controls and/or significant fraud in the financial systems of acquired companies; and
- difficulties in achieving business and financial success.

In the event that an acquired business or technology or an alliance does not meet our expectations, our results of operations may be adversely affected.

We could experience a breach of the confidentiality of the information we hold or of the security of our computer systems.

We operate large and complex computer systems that contain significant amounts of customer data. As a routine element of our business, we collect, analyze and retain substantial amounts of data pertaining to the preclinical and the clinical studies we conduct for our customers.

Unauthorized third parties could attempt to gain entry to such computer systems for the purpose of stealing data or disrupting the systems. We believe that we have taken adequate measures to protect them from intrusion, but in the event that our efforts are unsuccessful we could suffer significant harm. Our contracts with our customers typically contain provisions that require us to keep confidential the

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information generated from these studies. In the event the confidentiality of such information was compromised, we could suffer significant harm.

We depend on key personnel and may not be able to retain these employees or recruit additional qualified personnel, which would harm our business.

Our success depends to a significant extent on the continued services of our senior management and other members of management. James C. Foster, our Chief Executive Officer since 1992 and Chairman since 2000, has held various positions with us for over 30 years. We have no employment agreement with Mr. Foster or other members of our management. If Mr. Foster or other members of management do not continue in their present positions, our business may suffer.

Because of the specialized scientific nature of our business, we are highly dependent upon attracting and retaining qualified scientific, technical and managerial personnel. While we have an excellent record of employee retention, there is still strong competition for qualified personnel in the veterinary, pharmaceutical and biotechnology fields. Therefore, we may not be able to attract and retain the qualified personnel necessary for the development of our business. The loss of the services of existing personnel, as well as the failure to recruit additional key scientific, technical and managerial personnel in a timely manner, could harm our business.

Our quarterly operating results may vary, which could negatively affect the market price of our common stock.

Our results of operations in any quarter may vary from quarter to quarter and are influenced by such factors as:

- the number and scope of ongoing customer engagements,
- the commencement, postponement, progress, completion or cancellation of customer contracts in the quarter,
- changes in the mix of our products and services,
- the extent of cost overruns,
- holiday patterns of our customers,
- budget cycles of our customers,
- the timing and charges associated with completed acquisitions and other events, and
- exchange rate fluctuations.

We believe that operating results for any particular quarter are not necessarily a meaningful indication of future results. Nonetheless, fluctuations in our quarterly operating results could negatively affect the market price of our common stock

Item 1B. Unresolved Staff Comments

There are no unresolved comments to be reported in response to Item 1B.

Item 2. Properties

We own or lease the land and buildings where we have facilities. We own large facilities (facilities over 50,000 square feet) for our PCS businesses in the United States, Canada, Scotland and Ireland, and lease large facilities in the United States, Canada and China. We own large RMS facilities in the United Kingdom, France, Germany, Japan, Canada and the United States. None of our leases are individually material to our business operations and many have an option to renew. We believe that we will be able to successfully renew expiring leases on terms satisfactory to us. We believe that our facilities are adequate for our operations and that suitable additional space will be available when

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needed. For additional information see Note 9 to the Consolidated Financial Statements included elsewhere in this Form 10-K.

Item 3. Legal Proceedings

We are not a party to any material legal proceedings, other than ordinary routine litigation incidental to our business that is not material to our business or financial condition.

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

Not applicable.

Supplementary Item. Executive Officers of the Registrant ***(pursuant to Instruction 3 to Item 401(b) of Regulation S-K).***

Below are the names, ages and principal occupations of each our current executive officers. All such persons have been elected to serve until their successors are elected and qualified or until their earlier resignation or removal.

Thomas F. Ackerman, age 54, joined us in 1988 with over eleven years of combined public accounting and international finance experience. He was named Controller, North America in 1992 and became our Vice President and Chief Financial Officer in 1996. In 1999, he was named a Senior Vice President and in 2005 he was named a Corporate Executive Vice President. He is currently responsible for overseeing our Accounting and Finance Department and several other corporate staff departments. Prior to joining us, Mr. Ackerman was an accountant at Arthur Andersen & Co.

Christophe Berthoux, age 46, rejoined us in February 2005 as General Manager of our clinical services business. Following the sale of our Phase II-IV clinical services business in August 2006, Dr. Berthoux was named Corporate Senior Vice President, U.S. Research Models and Services and In Vitro Products and Services, and in 2008 he was named our Corporate Executive Vice President, Global Sales and Marketing and Chief Commercial Officer. Previously, from 1990 to early 2004, Dr. Berthoux held a variety of managerial positions with the Company, including Corporate Vice President and head of European Research Models and Services.

James C. Foster, age 58, joined us in 1976 as General Counsel. Over the past 30 years, Mr. Foster has held various staff and managerial positions, and was named our President in 1991, Chief Executive Officer in 1992 and our Chairman in 2000.

Nancy A. Gillett, age 53, joined us in 1999 with the acquisition of Sierra Biomedical. Dr. Gillett has 22 years of experience as an ACVP board certified pathologist and scientific manager. In 1999, she became Senior Vice President and General Manager of our Sierra Biomedical division, and subsequently held a variety of managerial positions, including President and General Manager of Sierra Biomedical and Corporate Vice President and General Manager of Drug Discovery and Development (the predecessor to our Preclinical Services business segment). In 2004, Dr. Gillett was named Corporate Senior Vice President and President, Global Preclinical Services, and in 2006 she became a Corporate Executive Vice President.

David P. Johst, age 47, joined us in 1991 as Corporate Counsel and was named Vice President, Human Resources in 1995. He became Vice President, Human Resources and Administration in 1996, a Senior Vice President in 1999, and a Corporate Executive Vice President in 2005. He currently serves as the Company's Chief Administrative Officer and is responsible for overseeing our Human Resources department, our Consulting and Staffing Services business unit and several other corporate staff departments. Prior to joining the Company, Mr. Johst was an attorney in the Corporate Department at Hale and Dorr.

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Real H. Renaud, age 62, joined us in 1964 and has over 40 years of research models production and related management experience. In 1986, Mr. Renaud became Vice President of Production, with responsibility for overseeing the Company's North American small animal operations, and was named Vice President, Worldwide Production in 1990. Mr. Renaud became Vice President and General Manager, European and North American Animal Operations in 1996, following a two-year European assignment during which he provided direct oversight to our European operations. In 1999, he became a Senior Vice President and in 2003, Mr. Renaud became Corporate Executive Vice President and President Global Research Models and Services.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock began trading on the New York Stock Exchange on June 23, 2000 under the symbol "CRL." The following table sets forth for the periods indicated below the high and low sales prices for our common stock.

2009	High	Low
First quarter (through February 13, 2009)	$29.87	$23.14

2008	High	Low
First quarter	$69.04	$53.73
Second quarter	65.95	55.14
Third quarter	69.19	57.84
Fourth quarter	58.00	19.92

2007	High	Low
First quarter	$47.64	$42.71
Second quarter	54.04	45.30
Third quarter	56.64	50.15
Fourth quarter	68.00	55.11

There were no equity securities that were not registered under the Securities Act of 1933, as amended, sold by the Company during the fiscal year ended December 27, 2008.

Shareholders

As of February 13, 2009 there were approximately 572 registered shareholders of the outstanding shares of common stock.

Dividends

We have not declared or paid any cash dividends on shares of our common stock in the past two years and we do not intend to pay cash dividends in the foreseeable future. We currently intend to retain any earnings to finance future operations and expansion. Some of the restrictive covenants contained in our revolving credit agreement and term loan agreements limit our ability to pay dividends.

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Issuer Purchases of Equity Securities

The following table provides information relating to the Company's purchases of shares of its common stock during the quarter ended December 27, 2008.

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
Sep. 28, 2008 Oct. 25, 2008	209,825	$ 46.91	209,308	$ 202,065,830
Oct. 26, 2008 Nov. 22, 2008	220,671	$ 28.49	220,000	$ 195,803,701
Nov. 23, 2008 Dec. 27, 2008	370,000	$ 23.42	370,000	$ 187,139,993
Total	800,496		799,308	

The Board of Directors of the Company has authorized a share repurchase program, originally authorized on July 27, 2005 and subsequently amended on October 26, 2005, May 9, 2006, August 1, 2007 and July 24, 2008 to acquire up to a total of $600.0 million of common stock. The program does not have a fixed expiration date.

During the quarter ended December 27, 2008, the Company repurchased 799,308 shares of common stock for approximately $24.7 million. The timing and amount of any future repurchases will depend on market conditions and corporate considerations. Additionally, the Company's Incentive Plans permit the netting of common stock upon vesting of restricted stock awards in order to satisfy individual tax withholding requirements. Accordingly, during the quarter ended December 27, 2008, the Company acquired 1,188 shares as a result of such withholdings.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table summarizes, as of December 27, 2008, the number of options issued under the Company's stock option plans and the number of options available for future issuance under these plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plan approved by security holders:			
Charles River 2000 Incentive Plan	3,459,396	$ 41.28	174,618
Charles River 1999 Management Incentive Plan	30,754	$ 14.52	15,617
Inveresk 2002 Stock Option Plan	136,305	$ 28.00	
2007 Incentive Plan	915,765(1)	$ 58.25	4,399,402
Equity compensation plans not approved by security holders			
Total	4,542,220(2)	$ 43.93	4,589,637(3)

(1) Includes shares payable under our performance awards granted in fiscal year 2008 under our 2007 Incentive Plan, utilizing 100% target award level of 61,100 shares; actual awards to be determined in February 2009 may differ from this number. The weighted-average exercise prices in column (b) do not take these performance awards into account.

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(2) None of the options outstanding under any equity compensation plan of the Company include rights to any dividend equivalents (i.e., a right to receive from the Company a payment commensurate to dividend payments received by holders of common stock or other equity instruments of the Company).

(3) On March 22, 2007, the Board of Directors determined that, upon approval of the 2007 Incentive Plan, no future awards would be granted under the preexisting equity compensation plans, including the Charles River 1999 Management Incentive Plan and the Charles River 2000 Incentive Plan. Shareholder approval was obtained on May 8, 2007. Previously, on February 28, 2005, the Board of Directors terminated the Inveresk 2002 Stock Option Plan to the extent that no further awards would be granted thereunder.

The following table provides additional information regarding the aggregate issuances under the Company's existing equity compensation plans as of December 27, 2008:

Category	Number of securities outstanding (a)	Weighted average exercise price (b)	Weighted average term (c)
Total number of restricted shares outstanding(1)	716,394	$	
Total number of options outstanding(2)	4,542,220	$ 43.93	5.02

(1) For purposes of this table, only unvested restricted stock as of December 27, 2008 is included. Also for purposes of this table only, the total includes 46,465 restricted stock units granted to certain employees of the Company outside of the United States.

(2) Includes shares payable under our performance awards granted in fiscal year 2008 under our 2007 Incentive Plan, utilizing target award level of 61,100 shares; actual awards determined in February 2009 differ from this number. The weighted-average exercise prices in column (b) do not take these performance awards into account.

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Comparision of 5-Year Cumulative Total Return

Among Charles River Laboratories International, Inc., The S&P 500 Index and The NASDAQ Pharmaceutical Index.

The following stock performance graph compares the annual percentage change in the Company's cumulative total shareholder return on its Common Stock during a period commencing on December 27, 2003 and ending on December 27, 2008 (as measured by dividing (1) the sum of (A) the cumulative amount of dividends for the measurement period, assuming dividend reinvestment, and (B) the difference between the Company's share price at the end and the beginning of the measurement period; by (2) the share price at the beginning of the measurement period) with the cumulative total return of the S&P 500 Index and the NASDAQ Pharmaceutical Index during such period. The Company has not paid any dividends on the Common Stock, and no dividends are included in the representation of the Company's performance. The stock price performance on the graph below is not necessarily indicative of future price performance. The graph is not "soliciting material," is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference in any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934 whether made before or after the date hereof and irrespective of any general incorporation language in any such filing. Information used in the graph was obtained from Standards & Poor's Institutional Market Services, a source believed to be reliable, but the Company is not responsible for any errors or omissions in such information.

	Dec. 27, 2003	Dec. 25, 2004	Dec. 31, 2005	Dec. 30, 2006	Dec. 29, 2007	Dec. 27, 2008
Charles River Laboratories International, Inc.	100.00	138.50	126.06	128.68	196.73	74.44
S&P 500	100.00	110.88	116.33	134.70	142.10	89.53
NASDAQ Pharmaceutical	100.00	110.22	111.87	114.89	106.37	97.32

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Item 6. Selected Consolidated Financial Data

The following selected financial data should be read in conjunction with Item 7., "Management's Discussion and Analysis of Financial Condition and Results of Operations" and consolidated financial statements and notes thereto contained in Item 8., "Financial Statements and Supplementary Data" of this report.

	Fiscal Year(1)				
	2008	2007	2006	2005	2004
	(dollars in thousands)				
Statement of Income Data:					
Net sales	$1,343,493	$1,230,626	$1,058,385	$ 993,328	$ 724,221
Cost of products sold and services provided	832,784	752,435	651,778	603,624	435,499
Selling, general and administrative expenses	230,159	217,491	180,795	157,999	116,879
Goodwill impairment	700,000				
Amortization of goodwill and intangibles	30,312	33,509	37,639	47,011	13,857
Operating income (loss)	(449,762)	227,191	188,173	184,694	157,986
Interest income	8,691	9,683	6,836	3,695	3,262
Interest expense	(14,009)	(18,004)	(19,426)	(24,324)	(11,718)
Other, net	(5,930)	(1,448)	981	(177)	937
Income (loss) before income taxes, minority interests and earnings from equity investments	(461,010)	217,422	176,564	163,888	150,467
Provision for income taxes	61,944	59,400	49,738	16,261	60,159
Income (loss) before minority interests and earnings from equity investments	(522,954)	158,022	126,826	147,627	90,308
Minority interests	687	(470)	(1,605)	(1,838)	(1,577)
Income (loss) from continuing operations	(522,267)	157,552	125,221	145,789	88,731
Income (loss) from discontinued businesses, net of tax	424	(3,146)	(181,004)	(3,790)	1,061
Net income (loss)	$ (521,843)	$ 154,406	$ (55,783)	$ 141,999	$ 89,792
Common Share Data:					
Earnings (loss) per common share					
Basic					
Continuing operations	$ (7.76)	$ 2.35	$ 1.82	$ 2.09	$ 1.79
Discontinued operations	$ 0.01	$ (0.05)	$ (2.63)	$ (0.05)	$ 0.02
Net income (loss)	$ (7.76)	$ 2.31	$ (0.81)	$ 2.04	$ 1.81
Diluted					
Continuing operations	$ (7.76)	$ 2.29	$ 1.79	$ 2.02	$ 1.65
Discontinued operations	$ 0.01	$ (0.05)	$ (2.59)	$ (0.05)	$ 0.02
Net income (loss)	$ (7.76)	$ 2.25	$ (0.80)	$ 1.96	$ 1.68
Other Data:					
Depreciation and amortization	$ 91,183	$ 86,379	$ 82,586	$ 87,935	$ 42,063
Capital expenditures	197,081	227,036	181,747	94,520	44,735
Balance Sheet Data (at end of period):					
Cash and cash equivalents	$ 243,592	$ 225,449	$ 175,380	$ 114,821	$ 207,566
Working capital	317,141	305,336	241,762	107,910	161,191
Goodwill, net	457,578	1,120,540	1,119,309	1,097,590	1,102,511
Total assets	2,159,918	2,805,537	2,557,544	2,538,209	2,626,835
Total debt	576,098	510,049	572,054	296,090	686,844
Total shareholders' equity	1,199,025	1,860,467	1,595,211	1,827,013	1,472,505

(1) Our fiscal year consists of 12 months ending on the last Saturday on, or prior to, December 31.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Continuing Operations

We are a leading global provider of solutions that advance the drug discovery and development process, including research models and associated services and outsourced preclinical services. We provide our products and services to global pharmaceutical companies, biotechnology companies, as well as government agencies, and leading hospitals and academic institutions throughout the world in order to bring drugs to market faster and more efficiently. Our broad portfolio of products and services enables our customers to reduce costs, increase speed to market and enhance their productivity and effectiveness in drug discovery and development. We have built upon our core competency of laboratory animal medicine and science (research model technologies) to develop a diverse and growing portfolio of regulatory compliant preclinical services which address drug discovery and development in the preclinical arena. We have been in business for over 60 years and currently operate approximately 70 facilities in 17 countries worldwide.

Our sales growth in 2008 was driven by continued spending by major pharmaceuticals, biotechnology companies and academic institutions on our global products and services, which aid in their development of new drugs and products, partially offset by the impact of the slower economy and world wide credit crisis. We expect the long-term drivers for our business as a whole primarily to emerge from our customers' continued demand for research models and services and regulatory compliant preclinical services, as well as increased strategic focus on outsourcing. During the second half of 2008, demand for our services decelerated at a greater rate than products impacting our growth rate. We believe this was primarily due to emerging factors which include: business restructuring and reprioritization of pipelines by pharmaceutical and biotechnology clients, which led to significant and accelerating study slippage and delays; lack of funding for biotechnology companies; and tight cost controls which resulted in more measured spending and some pricing pressure.

Our 2009 expectations reflect softer market demand, particularly for preclinical services which will continue at least until mid-year. We believe that our clients will continue to outsource drug development services as they strive to improve the efficiency of their drug pipelines. For additional discussion of the factors that we believe are influencing outsourcing demand from our customers, please see the section entitled "Our Strategy" included elsewhere in this Form 10-K.

We are using this period of market uncertainty to streamline our operations, and have implemented additional actions to improve our operating efficiency. These actions include initiating a hiring freeze, a salary freeze for a substantial percentage of our workforce, including all incentive-eligible employees, continued tight control of discretionary spending and implementing a headcount reduction affecting 3% of our total workforce (predominately in our PCS business segment) and the closure of our Arkansas facility. As a result of these cost-saving actions, the Company will take a one-time charge in 2009 of approximately $9.0 million. The Company expects that these actions will reduce costs by approximately $20.0 million in 2009, with an annual run-rate of approximately $25.0 million. We also are pursuing strategic alternatives for our clinical Phase I operation in Scotland, with an intention to divest these operations.

Our capital expenditures totaled $197.1 million in 2008 and our planned capital expenditures in 2009 are in the range of $100 million to $120 million. As a result of the factors which are affecting our sales growth, we evaluated our expansion plans and determined that we have sufficient capacity to accommodate our clients' current demand. We expect to open the Sherbrooke (Canada) facility in the first half of 2009, in order to relieve capacity constraints at our Montreal facility. We have delayed the expansion of our Ohio facility until 2010, when we believe the industry will be better positioned to absorb additional capacity.

In addition to internally generated organic growth, our business strategy includes strategic "bolt-on" acquisitions that complement our business, increase the rate of our growth or geographically

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expand our existing services, as evidenced by our acquisitions of NewLab BioQuality AG and MIR Preclinical Services in 2008.

Our annual goodwill impairment assessment has historically been completed at the beginning of the fourth quarter. Based on our initial assessment (step one) for 2008, the fair value of our business units exceeded their carrying value therefore our goodwill was not impaired. As economic conditions worsened late in the fourth quarter and our business performance and outlook were not as strong as anticipated, coupled with a decrease in our market capitalization, management determined that circumstances had changed enough to trigger another goodwill impairment test as of December 27, 2008. Our analysis resulted in the determination that the fair value our PCS business was less than its carrying value. The second step of the goodwill impairment test involved us calculating the implied goodwill for the PCS business. The carrying value of the goodwill assigned to the PCS business exceeded the implied fair value of goodwill, resulting in a goodwill impairment of $700 million.

Total net sales in 2008 were $1.3 billion, an increase of 9.2% over 2007 with demand decelerating during the second half of the year. The sales increase was due primarily to increased customer demand and higher pricing in Research Models and Services (RMS), strong large model safety testing and certain specialty toxicology sales partially offset by slower demand for PCS due to our clients' restructuring and reprioritization efforts, particularly in Europe. The effect of foreign currency translation added 1.3% to sales growth. Our gross margin decreased to 38.0% of net sales compared to 38.9% of net sales in 2007, due primarily to lower sales growth.

Our operating loss for 2008 was $449.8 million compared to income of $227.2 million for 2007 primarily due to the goodwill impairment of $700 million in 2008.

Net loss from continuing operations was $522.3 million in 2008 compared to income of $157.6 million in 2007. Diluted loss per share from continuing operations for 2008 was $7.76 compared to earnings per share of $2.29 in 2007.

We report two segments: RMS and PCS, which reflect the manner in which our operating units are managed.

Our RMS segment, which represented 49.1% of net sales in 2008, includes sales of research models, genetically engineered models and services (GEMS), research animal diagnostics, discovery and imaging services, consulting and staffing services, vaccine support and in vitro technology (primarily endotoxin testing). Although demand decelerated during the second half of the year, net sales for this segment increased 14.3% compared to 2007 due to increased small model sales in the United States and Europe, increased consulting and staffing services and strong in vitro sales. Favorable foreign currency translation increased the net sales gain by 3.7%. We experienced decreases in both the RMS gross margin and operating margin compared to last year (to 43.1% from 43.2% and to 30.1% from 30.7%, respectively) due mainly to the impact of the greater proportion of services in the sales mix and the second-quarter increase in operating expenses in Japan.

Our PCS segment, which represented 50.9% of net sales in 2008, includes services required to take a drug through the development process including discovery support, toxicology, pathology, biopharmaceutical, bioanalysis, pharmacokinetics and drug metabolism services, as well as Phase I clinical trials. Sales for this segment increased 4.6% over 2007, however, demand decelerated during the second half of the year. Sales were driven by continuing demand for large model safety testing and certain specialty toxicology studies as well as the acquisition of NewLab BioQuality AG, partially offset by more measured pharmaceutical spending due to our clients' restructuring and reprioritization efforts, particularly in Europe. Unfavorable foreign currency decreased sales growth by 0.9%. We experienced a decrease in the PCS gross margin during 2008 to 33.1% from 35.0% in 2007, due mainly to the lower sales growth and additional costs associated with the transition to the new preclinical facility in Nevada and start-up costs in China. As a result of the goodwill impairment, the 2008 operating margin was a negative 87.3% compared to 15.8% in 2007.

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Net Income

Net loss for 2008 was $521.8 million compared to income of $154.4 million in 2007.

Critical Accounting Policies and Estimates

The preparation of these financial statements requires management to use judgment when making assumptions that are involved in preparing estimates that affect the reported amounts of assets, liabilities, revenues and expenses during the reporting period. On an ongoing basis, management evaluates its estimates and assumptions. Some of those estimates can be complex and require management to make estimates about the future and actual results could differ from those estimates. Management bases its estimates and assumptions on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. For any given estimate or assumption made by management, there may also be other estimates or assumptions that are reasonable.

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses the consolidated financial statements of Charles River Laboratories International, Inc. which have been prepared in accordance with accounting principles generally accepted in the United States. Management believes the following critical accounting policies are most affected by significant judgments and estimates used in the preparation of our consolidated financial statements. The following summary should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this Form 10-K. We believe the following critical accounting policies and estimates reflect our more significant judgments and estimates than usual in the preparation of our consolidated financial statement:

Goodwill and other intangible assets;

Revenue recognition;

Pension plan accounting;

Stock-based compensation; and

Income taxes and deferred tax assets.

Goodwill, Other Intangible Assets We have intangible assets, including goodwill and other identifiable and indefinite-lived acquired intangibles on our balance sheet due to our acquisitions of businesses. The initial identification and valuation of these intangible assets and the determination of the estimated useful lives at the time of acquisition involve use of management judgments and estimates. These estimates are based on, among other factors, input from accredited valuation consultants, reviews of projected future income cash flows and statutory regulations. The use of alternative estimates and assumptions might have increased or decreased the estimated fair value of our goodwill and other intangible assets that could potentially result in a different impact to our results of operations.

We perform an annual impairment analysis of goodwill to determine if impairment exists. The goodwill impairment analysis is a two-step process. The first step is used to identify potential impairment and involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. Fair value is determined by using a weighted combination of a market-based approach and an income approach, as this combination is deemed to be the most indicative of our fair value in an orderly transaction between market participants. Under the market-based approach, we utilize information about our Company as well as publicly available industry information to determine earnings multiples and sales multiples that are used to value our reporting units. Under the income approach, we determine fair value based on the estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital which reflects the overall level of inherent risk of the reporting unit and the rate of return an outside investor would expect to earn. Determining

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the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates, profit margin percentages, discount rates, perpetuity growth rates, future capital expenditures and future market conditions, among others. Our projections are based on an internal strategic review. Key assumptions, strategies, opportunities and risks from this strategic review along with a market evaluation are the basis for our assessment. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is not considered to be impaired. However, if the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment.

The second step of the goodwill impairment process involves the calculation of an implied fair value of goodwill for each reporting unit for which step one indicated impairment. The implied fair value of goodwill is determined similar to how goodwill is calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit as calculated in step one, over the estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. In determining the fair value of assets we utilize appraisals for the fair value of property and equipment and valuations of certain intangible assets, including customer relationships.

Our annual goodwill impairment assessment has historically been completed at the beginning of the fourth quarter. Based on our initial assessment (step one) for 2008, the fair value of our business units exceeded their carrying value therefore our goodwill was not impaired. As economic conditions worsened late in the fourth quarter and our business performance and outlook was not as strong as anticipated coupled with a decrease in our market capitalization, management determined that circumstances had changed enough to trigger another goodwill impairment test as of December 27, 2008. Our analysis resulted in the determination that the fair value our PCS business was less than its carrying value. The second step of the goodwill impairment test involved us calculating the implied goodwill for the PCS business. The carrying value of the goodwill assigned to the PCS business exceeded the implied fair value of goodwill resulting in a goodwill impairment of $700 million.

Goodwill will not be amortized, but will be reviewed for impairment at least annually. The results of this year's impairment test are as of a point in time. If the future growth and operating results of our business are not as strong as anticipated and/or our market capitalization declines, this could impact the assumptions used in calculating the fair value in subsequent years. To the extent goodwill is impaired, its carrying value will be written down to its implied fair value and a charge will be made to our earnings. Such an impairment charge could materially and adversely affect our operating results and financial condition. As of December 27, 2008, we had recorded goodwill and other intangibles of $593.7 million in the consolidated balance sheet.

Revenue Recognition We recognize revenue on product and services sales. We record product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable and collectability is reasonably assured. Recognition of service revenue is primarily based on the completion of agreed-upon service procedures including rate specified contracts and fixed fee contracts. Revenue of agreed-upon rate contracts is recognized as services are performed, based on rates specified in the contract. Revenue of fixed fee contracts is recognized as services are performed in relation to estimated costs to complete procedures specified by the customers in the form of study protocols. Our fixed fee service contracts, which are utilized mainly in our Preclinical segment, vary in term from a few days to greater than a year, with the majority of such contracts having a term of less than six months. Management reviews the costs incurred and services provided to date on these contracts in relation to the total estimated effort to complete the contract. As a result of the reviews, revisions in estimated effort to complete the contract are reflected in the period in which the change became known. These judgments and estimates are not expected to result in a change that would materially affect our reported results. In some cases, a portion of the contract fee is paid at the time the study is initiated. These advances are recorded as deferred revenue and recognized as revenue as services are performed. Conversely, in some cases, revenue is recorded based on the level of service

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performed in advance of billing the customer with the offset to unbilled receivable. As of December 27, 2008, we had recorded unbilled revenue of $51.8 million and deferred revenue of $86.7 million in our consolidated balance sheet based on the difference between the estimated level of services performed and the billing arrangements defined by our service contracts.

Pension Plan Accounting As of December 27, 2008, we had a pension liability of $32.2 million. The actuarial computations require the use of assumptions to estimate the total benefits ultimately payable to employees and allocate this cost to the service periods. The key assumptions include the discount rate, the expected return on plan assets and expected future rate of salary increases. In addition, our actuaries determine the expense or liability of the plan using other assumptions for future experiences such as withdrawal and mortality rate. The key assumptions used to calculate pension costs are determined and reviewed annually by management after consulting with outside investment advisors and actuaries. The assumed discount rate, which is intended to be the actual rate at which benefits could effectively be settled, is adjusted based on the change in the long-term bond yield as of the measurement date. As of December 27, 2008, the weighted-average discount rate for our pension plans was 5.74%.

The assumed expected return on plan assets is the average return expected on the funds invested or to be invested to provide future benefits to pension plan participants. This includes considering the assets allocation and expected returns likely to be earned over the life of the plan. If the actual return is different from the assumed expected return in plan assets, the difference would be amortized over a period of approximately 15 to 20 years. The estimated effect of a 1.0% change in the expected rate of return would increase or decrease pension expense by $1.3 million.

During 2008, our Board of Directors voted to freeze the accrual of benefits under our U.S. pension plan effective April 30, 2008. In accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," we recorded a curtailment gain of $3.3 million in 2008.

Stock-based Compensation We recognize compensation expense for all share-based payment awards made to employees and directors including employee stock options and restricted stock awards based on estimated fair values. Accordingly, stock-based compensation cost is measured at grant date, based on the estimated fair value of the award and is recognized as expense on a straight-line basis over the requisite service period which is generally the vesting period. During the year ended December 27, 2008, we recognized $24.3 million of stock compensation expense associated with stock options, restricted stock and performance based stock awards.

We estimate the fair value of stock options using the Black-Scholes option-pricing model and the fair value of our restricted stock awards and restricted stock units based on the quoted market price of our common stock. We recognize the associated compensation expense on a straight-line basis over the vesting periods of the awards, net of estimated forfeitures. Forfeiture rates are estimated based on historical pre-vesting forfeitures and are updated on vesting date to reflect actual forfeitures.

Estimating the fair value for stock options requires judgment, including estimating stock-price volatility, expected term, expected dividends and risk-free interest rates. The expected volatility rates are estimated based on historical volatilities of our common stock over a period of time that approximates the expected term of the options. The expected term represents the average time that options are expected to be outstanding and is estimated based on the historical exercise and post-vesting cancellation patterns of our stock options. Expected dividends are estimated based on our dividend history as well as our current projections. The risk-free interest rate is based on the market yield of U.S. Treasury securities for periods approximating the expected terms of the options in effect at the time of grant. These assumptions are updated on at least an annual basis or when there is a significant change in circumstances that could affect these assumptions.

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The fair value of option based stock awards granted during 2008 was estimated on the grant date using the Black-Scholes option pricing model with the following weighted-average assumptions:

	December 27, 2008
Expected life (in years)	4.5
Expected volatility	24.0%
Risk-free interest rate	2.76%
Expected dividend yield	0.0%
Weighted-average option grant date fair value	$ 14.85

Income Taxes As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our current tax expense and assessing temporary and permanent differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We must assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. In the event that actual results differ from these estimates, or we adjust these estimates in future periods, we may need to establish an additional valuation allowance which could impact our financial position or results of operations.

As of December 27, 2008, earnings of non-U.S. subsidiaries considered to be indefinitely reinvested totaled $192.9 million. No provision for U.S. income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, we would be subject to both U.S. Federal and state taxes and withholding taxes payable to the various foreign countries. It is not practicable to estimate the amount of additional tax that might be payable on this undistributed foreign income.

We are a worldwide business and operate in various tax jurisdictions where tax laws and tax rates are subject to change given the political and economic climate in these countries. We report and pay income taxes based upon operational results and applicable law. Our tax provision is based upon enacted tax rates in effect to determine both the current and deferred tax position. Any significant fluctuation in tax rates or changes in tax laws could cause our estimate of taxes to change resulting in either increases or decreases in our effective tax rate.

Effective December 31, 2006, we adopted the provisions of FIN 48 "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109," which clarifies the accounting for income tax positions by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on the derecognition of previously recognized income tax items, measurement, classification, interest and penalties, accounting in interim periods and financial statement disclosure. Under FIN 48, we recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the tax position. The tax benefits recognized in our financial statements from such positions are measured on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution.

Due to our size and the number of tax jurisdictions within which we conduct our global business operations, we are subject to income tax audits on a regular basis. As a result, we have tax reserves which are attributable to potential tax obligations around the world. We believe we have sufficiently provided for all audit exposures and assessments. Settlements of these audits or the expiration of the statute of limitations on the assessment of income taxes for any tax year may result in an increase or decrease to our effective tax rate.

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Segment Operations

The following tables show the net sales and the percentage contribution of each of our reportable segments for the past three years. They also show cost of products sold and services provided, selling, general and administrative expenses, amortization of goodwill and intangibles and operating income by segment and as percentages of their respective segment net sales.

	Fiscal Year Ended		
	December 27, 2008	December 29, 2007	December 30, 2006
	(dollars in millions)		
Net sales:			
Research models and services	$ 659.9	$ 577.2	$ 515.0
Preclinical services	683.6	653.4	543.4
Cost of products sold and services provided:			
Research models and services	$ 375.3	$ 327.9	$ 300.9
Preclinical services	457.5	424.5	350.9
Goodwill impairment			
Research models and services	$	$	$
Preclinical services	700.0		
Selling, general and administrative expenses:			
Research models and services	$ 83.3	$ 70.3	$ 65.9
Preclinical services	94.8	93.7	73.0
Unallocated corporate overhead	52.1	53.5	41.9
Amortization of other intangibles:			
Research models and services	$ 2.6	$ 1.9	$ 0.4
Preclinical services	27.7	31.6	37.2
Operating income (loss):			
Research models and services	$ 198.7	$ 177.1	$ 147.8
Preclinical services	(596.4)	103.6	82.3
Unallocated corporate overhead	(52.1)	(53.5)	(41.9)

	Fiscal Year Ended		
	December 27, 2008	December 29, 2007	December 30, 2006
Net sales:			
Research models and services	49.1%	46.9%	48.7%
Preclinical services	50.9%	53.1%	51.3%
Cost of products sold and services provided:			
Research models and services	56.9%	56.8%	58.4%
Preclinical services	66.9%	65.0%	64.6%
Goodwill impairment			
Research models and services			
Preclinical services	102.4%		
Selling, general and administrative expenses:			
Research models and services	12.6%	12.2%	12.8%
Preclinical services	13.9%	14.3%	13.4%
Unallocated corporate overhead			
Amortization of other intangibles:			
Research models and services	0.4%	0.3%	0.1%
Preclinical services	4.1%	4.8%	6.8%
Operating income:			
Research models and services	30.1%	30.7%	28.7%
Preclinical services	(87.3)%	15.9%	15.2%
Unallocated corporate overhead	(3.9)%	(4.3)%	(4.0)%

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In our consolidated statements of income, we provide a breakdown of net sales and cost of sales between net products and services. Such information is reported irrespective of the business segment from which the sales were generated.

Results of Operations

The following table summarizes historical results of operations as a percentage of net sales for the periods shown:

	Fiscal Year Ended		
	December 27, 2008	December 29, 2007	December 30, 2006
Net sales	100.0%	100.0%	100.0%
Cost of products sold and services provided	62.0%	61.1%	61.6%
Selling, general and administrative expenses	17.1%	17.7%	17.0%
Goodwill impairment	52.1%		
Amortization of other intangibles	2.3%	2.7%	3.6%
Operating income (loss)	(33.5)%	18.5%	17.8%
Interest income	0.6%	0.8%	0.6%
Interest expense	1.0%	1.5%	1.8%
Provision for income taxes	4.6%	4.8%	4.7%
Minority interests	0.1%	%	0.2%
Income (loss) from continuing operations	(38.9)%	12.8%	11.8%

Fiscal 2008 Compared to Fiscal 2007

Net Sales. Net sales in 2008 were $1,343.5 million, an increase of $112.9 million, or 9.2%, from $1,230.6 million in 2007.

Research Models and Services. In 2008, net sales for our RMS segment were $659.9 million, an increase of $82.7 million, or 14.3%, from $577.2 million in 2007, due to increased small model sales in the United States and Europe, increased consulting and staffing services and strong in vitro sales. Favorable foreign currency translation increased sales growth by approximately 3.7%. RMS sales increased due to pricing and unit volume increases in both models, including large models, and services. The RMS sales growth was driven by increases in basic research and biotechnology spending, which drove greater demand for our products and services.

Preclinical Services. In 2008, net sales for our PCS segment were $683.6 million, an increase of $30.2 million, or 4.6%, compared to $653.4 million in 2007. Sales were driven by continuing demand for large model safety testing and certain specialty toxicology studies as well as the acquisition of NewLab BioQuality AG, partially offset by more measured pharmaceutical spending due to our clients' restructuring and reprioritization efforts, particularly in Europe. Unfavorable foreign currency had a negative impact on sales growth by 0.9%.

Cost of Products Sold and Services Provided. Cost of products sold and services provided in 2008 was $832.8 million, an increase of $80.4 million, or 10.7%, from $752.4 million in 2007. Cost of products sold and services provided in 2008 was 62.0% of net sales, compared to 61.1% in 2007.

Research Models and Services. Cost of products sold and services provided for RMS in 2008 was $375.3 million, an increase of $47.5 million, or 14.5%, compared to $327.8 million in 2007. Cost of products sold and services provided as a percentage of net sales in 2008 was 56.9% compared to 56.8% in 2007. The greater facility utilization was the result of the increased sales during the quarter, partially offset by an unfavorable product mix due to greater growth in the lower margin service area.

Preclinical Services. Cost of services provided for the PCS segment in 2008 was $457.5 million, an increase of $32.9 million, or 7.8%, compared to $424.6 million in 2007. Cost of services provided as a

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percentage of net sales was 66.9% in 2008, compared to 65.0% in 2007. The increase in cost of services provided as a percentage of net sales was primarily due to the impact of lower sales growth and the start-up and transition costs of PCS Nevada facilities.

Selling, General and Administrative Expenses. Selling, general and administrative expenses in 2008 were $230.2 million, an increase of $12.7 million, or 5.8%, from $217.5 million in 2007. Selling, general and administrative expenses in 2008 were 17.1% of net sales compared to 17.7% of net sales in 2007.

Research Models and Services. Selling, general and administrative expenses for RMS in 2008 were $83.3 million, an increase of $13.0 million, or 18.5%, compared to $70.3 million in 2007. Selling, general and administrative expenses increased as a percentage of sales to 12.6% in 2008 from 12.2% in 2007 due mainly to higher operating costs.

Preclinical Services. Selling, general and administrative expenses for the PCS segment in 2008 were $94.8 million, an increase of $1.1 million, or 1.2%, compared to $93.7 million in 2007. Selling, general and administrative expenses in 2008 decreased to 13.9% of net sales compared to 14.3% in 2007.

Unallocated Corporate Overhead. Unallocated corporate overhead, which consists of various costs primarily related to activities centered at our corporate headquarters, such as compensation (including stock-based compensation), information systems, compliance and facilities expenses associated with our corporate, administration and professional services functions was $52.1 million in 2008, compared to $53.5 million in 2007. The decrease in unallocated corporate overhead in 2008 was primarily due to the gain associated with the curtailment of the U.S. pension plan and slower growth in health care costs.

Amortization of Other Intangibles. Amortization of other intangibles in 2008 was $30.3 million, a decrease of $3.2 million, from $33.5 million in 2007.

Research Models and Services. In 2008, amortization of other intangibles for our RMS segment was $2.6 million, an increase of $0.7 million from $1.9 million in 2007.

Preclinical Services. In 2008, amortization of other intangibles for our PCS segment was $27.7 million, a decrease of $3.9 million from $31.6 million in 2007.

Goodwill Impairment. Our annual goodwill impairment assessment has historically been completed at the beginning of the fourth quarter. Based on our initial assessment (step one) for 2008, the fair value of our business units exceeded their carrying value therefore our goodwill was not impaired. As economic conditions worsened late in the fourth quarter and our business performance and outlook was not as strong as anticipated coupled with a decrease in our market capitalization, management determined that circumstances had changed enough to trigger another goodwill impairment test as of December 27, 2008. Our analysis resulted in the determination that the fair value our PCS business was less than its carrying value. The second step of the goodwill impairment test involved us calculating the implied goodwill for the PCS business. The carrying value of the goodwill assigned to the PCS business exceeded the implied fair value of goodwill resulting in a goodwill impairment of $700 million.

Operating Income. Operating loss in 2008 was $449.8 million, compared to operating income of $227.2 million in 2007.

Research Models and Services. In 2008, operating income for our RMS segment was $198.7 million, an increase of $21.5 million, or 12.2%, from $177.2 million in 2007. Operating income as a percentage of net sales in 2008 was 30.1%, compared to 30.7% in 2007. The decrease in operating income as a percentage of sales was primarily due to increased operating expenses offset by improved utilization due to the higher sales volume.

Preclinical Services. In 2008, operating loss for our PCS segment was $596.4 million, compared to operating income of $103.5 million in 2007. The decrease in operating income as a percentage of net sales was primarily due to goodwill impairment as well as to the start-up and transition costs for our

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PCS Nevada facilities partially offset by improved operating efficiency as a result of higher sales and lower amortization costs.

Interest Expense. Interest expense in 2008 was $14.0 million, compared to $18.0 million in 2007, due primarily to lower outstanding debt and lower interest rates.

Interest Income. Interest income in 2008 was $8.7 million compared to $9.7 million in 2007.

Income Taxes. Income tax expense in 2008 was $61.9 million, an increase of $2.5 million compared to $59.4 million in 2007. Our effective tax rate in 2008 was (13.4)% which was adversely impacted by the goodwill impairment by (40.5)%. Our 2007 effective tax rate was 27.3%. The change from 2007 to 2008 effective tax rate was primarily due to the goodwill impairment.

Net Income(Loss). Net loss in 2008 was $521.8 million compared to net income of $154.4 million in 2007.

Fiscal 2007 Compared to Fiscal 2006

Net Sales. Net sales in 2007 were $1,230.6 million, an increase of $172.2 million, or 16.3%, from $1,058.4 million in 2006.

Research Models and Services. In 2007, net sales from our RMS segment were $577.2 million, an increase of $62.2 million, or 12.1%, from $515.0 million in 2006. Favorable foreign currency translation increased our net sales gain by 2.9%. RMS sales increased due to pricing and unit volume increases in both models and services. The RMS sales growth was driven by increases in basic research and biotechnology spending, which drove greater demand for our products and services, partially offset by lower sales growth in research models in Japan.

Preclinical Services. In 2007, net sales from our Preclinical Services segment were $653.4 million, an increase of $110.0 million, or 20.2%, compared to $543.4 million in 2006. The increase was primarily due to the increased customer demand for toxicology and other specialty preclinical services, reflecting increased customer outsourcing along with the full year impact of the acquisition of Northwest Kinetics. Favorable foreign currency increased sales growth by 2.9%.

Cost of Products Sold and Services Provided. Cost of products sold and services provided in 2007 was $752.4 million, an increase of $100.6 million, or 15.4%, from $651.8 million in 2006. Cost of products sold and services provided in 2007 was 61.1% of net sales, compared to 61.6% in 2006.

Research Models and Services. Cost of products sold and services provided for RMS in 2007 was $327.9 million, an increase of $27.0 million, or 9.0%, compared to $300.9 million in 2006. Cost of products sold and services provided in 2007 decreased to 56.8% of net sales compared to 58.4% of net sales in 2006. The favorable cost of products sold and services provided as a percentage of sales was due to greater facility utilization as a result of increased sales.

Preclinical Services. Cost of services provided for the Preclinical Services segment in 2007 was $424.5 million, an increase of $73.6 million, or 21.0%, compared to $350.9 million in 2006. Cost of services provided as a percentage of net sales was 65.0% in 2007, compared to 64.6% in 2006. The increase in cost of services provided as a percentage of net sales was primarily due to the impact of increased costs related to the transition to our new Massachusetts facility and the foreign exchange impact of the strengthening Canadian dollar, partially offset by improved performance at certain PCS locations.

Selling, General and Administrative Expenses. Selling, general and administrative expenses in 2007 were $217.5 million, an increase of $36.7 million, or 20.3%, from $180.8 million in 2006. Selling, general and administrative expenses in 2007 were 17.7% of net sales compared to 17.1% of net sales in 2006. The increase as a percentage of sales was due primarily to increases in unallocated corporate overhead and charges related to the accelerated exit of our Worcester facility.

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Research Models and Services. Selling, general and administrative expenses for RMS in 2007 were $70.3 million, an increase of $4.4 million, or 6.8%, compared to $65.9 million in 2006. Selling, general and administrative expenses decreased as a percentage of sales to 12.2% in 2007 from 12.8% in 2006 due mainly to greater economies of scale.

Preclinical Services. Selling, general and administrative expenses for the Preclinical Services segment in 2007 were $93.7 million, an increase of $20.7 million, or 28.3%, compared to $73.0 million in 2006. Selling, general and administrative expenses in 2007 increased to 14.3% of net sales, compared to 13.4% of net sales in 2006 due to charges related to the accelerated exit of our Worcester facility.

Unallocated Corporate Overhead. Unallocated corporate overhead, which consists of various corporate expenses including those associated with stock based compensation, pension and departments such as senior executives, corporate accounting, legal, tax, treasury, global informational technology, human resources and investor relations, was $53.5 million in 2007, compared to $41.9 million in 2006. The increase in unallocated corporate overhead in 2007 was due to increased equity based compensation, higher information technology costs and higher bonus accruals.

Amortization of Other Intangibles. Amortization of other intangibles in 2007 was $33.5 million, a decrease of $4.1 million, from $37.6 million in 2006. The decreased amortization was primarily due to reduced amortization related to the acquisition of Inveresk.

Research Models and Services. In 2007, amortization of other intangibles for our RMS segment was $1.9 million, an increase of $1.5 million from $0.4 million in 2006. The increased amortization was primarily due to the acquisition of the remaining 15% of the equity of Charles River Laboratories Japan, Inc., from the minority interest partner in the first quarter of 2007.

Preclinical Services. In 2007, amortization of other intangibles for our Preclinical Services segment was $31.6 million, a decrease of $5.6 million from $37.2 million in 2006. The decrease in amortization of other intangibles was primarily due to reduced amortization related to the Inveresk acquisition.

Operating Income. Operating income in 2007 was $227.2 million, an increase of $39.0 million, or 20.7%, from $188.2 million in 2006. Operating income in 2007 was 18.5% of net sales, compared to 17.8% of net sales in 2006. The increase as a percentage of sales was due primarily to increased operating income margins in RMS along with lower amortization costs.

Research Models and Services. In 2007, operating income for our RMS segment was $177.2 million, an increase of $29.4 million, or 19.9%, from $147.8 million in 2006. Operating income as a percentage of net sales in 2007 was 30.7%, compared to 28.7% in 2006. The increase in operating income as a percentage of sales was primarily due to improved capacity utilization resulting from the higher sales volume.

Preclinical Services. In 2007, operating income for our Preclinical Services segment was $103.5 million, an increase of $21.2 million, or 25.8%, from $82.3 million in 2006. Operating income as a percentage of net sales increased to 15.8%, compared to 15.2% of net sales in 2006. The increase in operating income as a percentage of net sales was primarily due to higher sales which resulted in improved operating efficiency and lower amortization costs, partially offset by the start-up and transition costs for our PCS Massachusetts facilities and the foreign exchange impact of the strengthening Canadian dollar.

Interest Income. Interest income in 2007 was $9.7 million, compared to $6.8 million in 2006. The $2.9 million increase was primarily due to increased funds invested.

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Interest Expense. Interest expense in 2007 was $18.0 million, compared to $19.4 million in 2006. The $1.4 million decrease was primarily due to debt repayment.

Income Taxes. Income tax expense for 2007 was $59.4 million, an increase of $9.7 million compared to $49.7 million in 2006. Our effective tax rate for 2007 was 27.3% compared to 28.2% for 2006. The decline in effective tax rate in 2007 was primarily due to benefits recorded in 2007 related to tax law changes in the United Kingdom and Germany and benefits generated due to mix of earnings.

Income from Continuing Operations. Income from continuing operations in 2007 was $157.6 million, an increase of $32.4 million from $125.2 million in 2006.

Loss from Discontinued Operations. The loss from discontinued operations in 2007 was $3.1 million. The loss from discontinued operations for 2006 was $181.0 million which included a goodwill impairment of $129.2 million, the tax expense of $37.8 million related to the sale of the Phase II-IV Clinical business, as well as results from our ISS business.

Net Income (Loss). Net income in 2007 was $154.4 million compared to a net loss of $55.8 million in 2006.

Liquidity and Capital Resources

The following discussion analyzes liquidity and capital resources by operating, investing and financing activities as presented in our condensed consolidated statements of cash flows.

Our principal sources of liquidity have been our cash flow from operations, the convertible debt offering, our marketable securities and our revolving line of credit arrangements.

We had marketable securities of $19.0 million and $63.4 million as of December 27, 2008 and December 29, 2007, respectively. The decline was primarily due to management's decision to move funds into cash equivalent type investments. As of December 27, 2008 and December 29, 2007, we had $19.0 million and $38.2 million invested in auction rate securities rated AAA by a major credit rating agency. Our auction rate securities are guaranteed by U.S. federal agencies. These auction rate securities provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, usually every 7 or 35 days. The overall credit concerns in the capital markets as well as the failed auctions of these securities have impacted our ability to liquidate these investments. The auctions for the securities we own continue to fail, the investment may not be readily convertible to cash until a future auction of these investments is successful. Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and other sources of cash, we do not anticipate the current lack of liquidity on these investments will affect our ability to operate our business as usual.

In 2006, we issued $350.0 million of 2.25% Convertible Senior Notes (the 2013 notes) due in 2013. At December 27, 2008, the fair value of our outstanding 2013 Notes was approximately $311.1 based on their quoted market value. During the fourth quarter of 2008 no conversion triggers were met.

Concurrently with the sale of the 2013 Notes, we entered into convertible note hedge transactions with respect to our obligation to deliver common stock under the 2013 Notes. The convertible note hedges give us the right to receive, for no additional consideration, the numbers of shares of common stock that we are obligated to deliver upon conversion of the 2013 Notes (subject to antidilution adjustments substantially identical to those in the 2013 Notes), and expire on June 15, 2013. The aggregate cost of these convertible note hedges was $98.3 million.

Separately and concurrently with the pricing of the 2013 Notes, we issued warrants for approximately 7.2 million shares of our common stock. The warrants give the holders the right to receive, for no additional consideration, cash or shares (at our option) with a value equal to the appreciation in the price of our shares above $59.925, and expire between September 13, 2013 and

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January 22, 2014 over 90 equal increments. The total proceeds from the issuance of the warrants were $65.4 million.

From our economic perspective, the cumulative impact of the purchase of the convertible note hedges and the sale of the warrants increases the effective conversion price of the 2013 Notes from $48.94 to $59.925 per share.

We currently have a $428 million credit agreement and a $50 million credit agreement. At December 27, 2008, we had term loans of $134.9 million and $90.0 million under our revolving credit facility outstanding. As of December 27, 2008, we had $104.4 million available to borrow under our revolving credit agreements. As of December 27, 2008, we were compliant with all financial covenants specified in the credit agreements. For additional information regarding the 2013 Notes, the $428 million credit agreement and the $50 million credit agreement, please see Note 4 included in the Notes to Consolidated Financial Statements included elsewhere in this Form 10-K.

During the first quarter of 2009, the Company plans to repatriate approximately $90.0 million of the earnings of its non-U.S. subsidiaries. As such, the Company has changed its permanent reinvestment assertion with regards to these unremitted earnings. As a result of the change in assertion, the Company recorded a tax benefit primarily due to foreign tax credits in the fourth quarter of 2008 of $7.2 million, of which $4.0 million was reflected in the effective tax rate and $3.2 million was reflected in the Cumulative Translation Account. The proceeds from the repatriation will be used for general corporate purposes. The Company continues to maintain its permanent reinvestment assertion with regards to the remaining unremitted earnings of its non-U.S. subsidiaries.

Our Board of Directors has authorized a share repurchase program, originally authorized on July 27, 2005 and subsequently amended on October 26, 2005, May 9, 2006, August 1, 2007 and July 24, 2008 to acquire up to a total of $600.0 million of common stock. The program does not have a fixed expiration date. In order to facilitate these share repurchases, the Company has entered into Rule 10b5-1 Purchase Plans. As of December 27, 2008, approximately $187.1 million remained authorized for share repurchases.

Cash and cash equivalents totaled $243.6 million at December 27, 2008 compared to $225.4 million at December 29, 2007.

Net cash provided by operating activities in 2008 and 2007 was $279.5 million and $288.4 million, respectively. The decrease in cash provided by operations was primarily due to a decrease in deferred revenue. Our days sales outstanding (DSO) of 40 days as of December 27, 2008 increased from 35 days at December 29, 2007. Our DSO includes deferred revenue as an offset to accounts receivable in the calculation.

Net cash used in investing activities in 2008 and 2007 was $227.2 million and $200.8 million, respectively. Our capital expenditures in 2008 were $197.1 million of which $60.5 million was related to RMS and $136.6 million to PCS. For 2009 we project capital expenditures to be in the range of $100 to $120 million. We anticipate that future capital expenditures will be funded by operating activities and existing credit facilities.

Net cash used in financing activities in 2008 was $17.3 million and $46.4 million in 2007. During 2008, we purchased $115.1 million of treasury stock and repaid debt of $36.5 million partially offset by proceeds from exercises of employee stock options and warrants of $28.5 million and proceeds from debt of $102.0 million. During 2007, we purchased $41.6 million of treasury stock and repaid $64.5 million of debt, partially offset by proceeds from exercises of employee stock options of $54.0 million.

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Minimum future payments of our contractual obligations at December 27, 2008 are as follows:

Contractual Obligations	Total	Less than 1 Year	1 3 Years	3 5 Years	After 5 Years
Debt	$575.8	$ 35.4	$ 190.4	$ 350.0	$
Interest payments	45.6	12.8	28.8	4.0	
Operating leases	98.3	21.4	24.8	17.4	34.7
Pension	94.5	9.4	9.7	28.7	46.7
Construction commitments	27.4	27.4			
Total contractual cash obligations	$841.6	$ 106.4	$ 253.7	$ 400.1	$81.4

The above table does not reflect unrecognized tax benefits of $28.7 million. Refer to Note 6 to the Consolidated Financial Statements for additional discussion on unrecognized tax benefits.

Off-Balance Sheet Arrangements

The conversion features of our 2013 Notes are equity-linked derivatives. As such, we recognize these instruments as off-balance sheet arrangements. The conversion features associated with these notes would be accounted for as derivative instruments, except that they are indexed to our common stock and classified in stockholders' equity. Therefore, these instruments meet the scope of exception of paragraph 11(a) of SFAS No. 133, "Accounting for Derivatives Instruments and Hedging Activities," and are accordingly not accounted for as derivatives for purposes of SFAS No. 133.

Recent Accounting Pronouncements

In June, the FASB issued FSP No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" (FSP EITF 03-6-1) which clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities. As participating securities, these instruments should be included in the calculation of basic earnings per share. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, as well as interim periods within those years. Once effective, all prior-period earnings per share data presented must be adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform with the provisions of the FSP. Early application is not permitted. Upon adoption of FSP EITF 03-6-1, we expect to revise prior period earning per share from continuing operations as follows: decrease 2008 basic and diluted loss per share by $0.08; reduce 2007 basic and diluted earning per share by $0.02 and reduce 2006 basic earning per share by $0.02 and diluted earning per share from continuing operations by $0.01.

In May 2008, the FASB issued FSP No. APB 14-1 "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" (FSP 14-1). This FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years and will be applied retrospectively to all periods presented. We estimate that upon adoption of the provisions of FSP 14-1, $261,508 of the total proceeds from our debt will be allocated to the liability component, which represents the estimated fair value of similar debt instruments without the conversion option as of the date of issuance. The remaining $88,492 will be allocated to the equity component. The debt discount of $88,492 will be amortized to interest expense over the seven year period from June 2006 to June 2013, the expected life of the instrument. Additionally, upon adoption, approximately $1,903 of deferred financing costs capitalized at the time of issuance will be reclassified to equity as equity issuance costs and will not be amortized to interest expense.

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In March 2008, the FASB issued SFAS No. 161 "Disclosures about Derivative Instruments and Hedging Activities" (FAS 161). FAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FASB Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This statement is not expected to have an impact on our consolidated financial statements.

In February 2008, the FASB issued FSP 157-1 and 157-2 that (1) partially deferred the effective date of SFAS 157 for one year for certain nonfinancial assets and nonfinancial liabilities and (2) removed certain leasing transactions from the scope of SFAS 157. SFAS 157 as amended by this FSP is effective for nonfinancial assets and liabilities in fiscal years beginning after November 15, 2008 and will be applied prospectively. The provisions of SFAS 157 will not have a material impact on our consolidated financial statements.

In February 2008, the FASB issued FSP FAS 140-3: "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions" (FSP 140-3). FSP 140-3 provides guidance on accounting for a transfer of a financial asset and a repurchase financing. This FSP presumes that an initial transfer for a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under Statement 140. However, if certain criteria are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under Statement 140. This FSP is not expected to have an impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" (SFAS 141(R)) and No. 160, "Noncontrolling Interests in Consolidated Financial Statements" (SFAS 160). SFAS 141(R) and SFAS 160 introduce significant changes in the accounting for and reporting of business acquisitions and noncontrolling interests in a subsidiary. SFAS 141(R) continues the movement toward the greater use of fair values in financial reporting and increased transparency through expanded disclosures. SFAS 141(R) changes how business acquisitions are accounted for and will impact financial statements at the acquisition date and in subsequent periods. In addition, SFAS 141(R) will impact the annual goodwill impairment test associated with acquisitions that close both before and after its effective date. SFAS 141(R) amends SFAS 109 changing the accounting for adjustments to deferred tax asset valuation allowances and income tax uncertainties related to acquisitions that close both before and after its effective date, generally requiring adjustments to be reflected in income tax expense. SFAS 141(R) applies prospectively to fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. An entity may not apply SFAS 141(R) before that date. The adoption of SFAS 141(R) and SFAS 160 will impact our consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosure about Market Risk

Certain of our financial instruments are subject to market risks, including interest rate risk and foreign currency exchange rates. We generally do not use financial instruments for trading or other speculative purposes.

Interest Rate Risk

The fair value of our marketable securities is subject to interest rate risk and will fall in value if market interest rates increase. If market rates were to increase immediately and uniformly by 100 basis points from levels at December 27, 2008, then the fair value of the portfolio would decline by approximately $0.2 million.

We have entered into two credit agreements, the $428 million credit agreement and the $50 million credit agreement. Our primary interest rate exposure results from changes in LIBOR or the

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base rates which are used to determine the applicable interest rates under our term loans in the $428 million credit agreement and in the $50 million agreement and our revolving credit facilities. Our potential additional interest expense over one year that would result from a hypothetical, instantaneous and unfavorable change of 100 basis points in the interest rate would be approximately $3.3 million on a pre-tax basis.

We issued $350 million of the 2013 Notes in a private placement in the second quarter of 2006. The convertible senior debenture notes bear an interest rate of 2.25%. The fair market value of the outstanding notes was $311.1 million on December 27, 2008.

Foreign Currency Exchange Rate Risk

We operate on a global basis and have exposure to some foreign currency exchange rate fluctuations for our earnings and cash flows. This risk is mitigated by the fact that various foreign operations are principally conducted in their respective local currencies. However, a portion of our foreign operations' revenue is denominated in U.S. dollars, with the costs accounted for in their local currencies. We attempt to minimize this exposure by using certain financial instruments, for purposes other than trading, in accordance with our overall risk management and our hedge policy. In accordance with our hedge policy, we designate certain transactions as hedges as set forth in SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities."

During 2008, we utilized foreign exchange contracts, principally to hedge the impact of currency fluctuations on customer transactions and certain balance sheet items. No foreign exchange contracts were outstanding on December 27, 2008.

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Item 8. Financial Statements and Supplementary Data

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Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment our management concluded that, as of December 27, 2008, our internal control over financial reporting was effective based on those criteria.

The effectiveness of our internal control over financial reporting as of December 27, 2008 has been audited by PricewaterhouseCoopers LLP, an Independent Registered Public Accounting Firm, as stated in their report which is included herein.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Charles River Laboratories International, Inc:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Charles River Laboratories International, Inc and its subsidiaries at December 27, 2008 and December 29, 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 27, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 27, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 8. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 6 to the consolidated financial statements, the Company changed its method of accounting for uncertain tax positions as of December 31, 2006.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts
February 23, 2009

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CHARLES RIVER LABORATORIES INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

	Fiscal Year Ended		
	December 27, 2008	December 29, 2007	December 30, 2006
Net sales related to products	$ 471,741	$ 415,247	$ 374,832
Net sales related to services	871,752	815,379	683,553
Net sales	1,343,493	1,230,626	1,058,385
Costs and expenses			
Cost of products sold	252,938	225,088	211,008
Cost of services provided	579,846	527,347	440,770
Selling, general and administrative	230,159	217,491	180,795
Goodwill impairment	700,000		
Amortization of other intangibles	30,312	33,509	37,639
Operating income (loss)	(449,762)	227,191	188,173
Other income (expense)			
Interest income	8,691	9,683	6,836
Interest expense	(14,009)	(18,004)	(19,426)
Other, net	(5,930)	(1,448)	981
Income (loss) before income taxes and minority interests	(461,010)	217,422	176,564
Provision for income taxes	61,944	59,400	49,738
Income (loss) before minority interests	(522,954)	158,022	126,826
Minority interests	687	(470)	(1,605)
Income (loss) from continuing operations	(522,267)	157,552	125,221
Loss from discontinued operations, net of tax	424	(3,146)	(181,004)
Net income (loss)	$ (521,843)	$ 154,406	$ (55,783)
Earnings (loss) per common share			
Basic:			
Continuing operations	$ (7.76)	$ 2.35	$ 1.82
Discontinued operations	$ 0.01	$ (0.05)	$ (2.63)
Net income (loss)	$ (7.76)	$ 2.31	$ (0.81)
Diluted:			
Continuing operations	$ (7.76)	$ 2.29	$ 1.79
Discontinued operations	$ 0.01	$ (0.05)	$ (2.59)
Net income (loss)	$ (7.76)	$ 2.25	$ (0.80)

See Notes to Consolidated Financial Statements.

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CHARLES RIVER LABORATORIES INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share amounts)

	December 27, 2008	December 29, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 243,592	$ 225,449
Trade receivables, net	210,214	213,908
Inventories	96,882	88,023
Other current assets	67,218	79,477
Current assets of discontinued operations	233	1,007
Total current assets	618,139	607,864
Property, plant and equipment, net	828,921	748,793
Goodwill, net	457,578	1,120,540
Other intangibles, net	136,100	148,905
Deferred tax asset	62,935	89,255
Other assets	52,058	85,993
Long term assets of discontinued operations	4,187	4,187
Total assets	$ 2,159,918	$ 2,805,537
Liabilities and Shareholders' Equity		
Current liabilities		
Current portion of long-term debt and capital leases	$ 35,452	$ 25,051
Accounts payable	40,517	36,715
Accrued compensation	54,870	53,359
Deferred revenue	86,707	102,021
Accrued liabilities	60,741	61,366
Other current liabilities	22,676	23,268
Current liabilities of discontinued operations	35	748
Total current liabilities	300,998	302,528
Long-term debt and capital leases	540,646	484,998
Other long-term liabilities	118,827	154,044
Total liabilities	960,471	941,570
Commitments and contingencies		
Minority interests	422	3,500
Shareholders' equity		
Preferred stock, $0.01 par value; 20,000,000 shares authorized; no shares issued and outstanding		
Common stock, $0.01 par value; 120,000,000 shares authorized; 76,609,779 issued and 67,052,884 shares outstanding at December 27, 2008 and 75,427,649 issued and 68,135,324 shares outstanding at December 29, 2007	766	754
Capital in excess of par value	1,965,150	1,906,997
Retained (deficit) earnings	(344,314)	177,529
Treasury stock, at cost, 9,556,895 shares and 7,292,325 shares at December 27, 2008 and December 29, 2007, respectively	(425,924)	(310,372)
Accumulated other comprehensive income	3,347	85,559

Total shareholders' equity	1,199,025	1,860,467
Total liabilities and shareholders' equity	$ 2,159,918	$ 2,805,537

See Notes to Consolidated Financial Statements.

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CHARLES RIVER LABORATORIES INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

	Fiscal Year Ended		
	December 27, 2008	December 29, 2007	December 30, 2006
Cash flows relating to operating activities			
Net income (loss)	$ (521,843)	$ 154,406	$ (55,783)
Less: Income (loss) from discontinued operations	424	(3,146)	(181,004)
Income (loss) from continuing operations	(522,267)	157,552	125,221
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	91,183	86,379	82,586
Goodwill impairment	700,000		
Gain on pension curtailment	(3,276)		
Non-cash compensation	24,333	26,017	21,090
Deferred income taxes	12,671	(9,786)	4,035
Other, net	9,019	9,056	1,659
Changes in assets and liabilities:			
Trade receivables	(8,532)	(492)	(18,961)
Inventories	(9,670)	(12,988)	(6,475)
Other assets	6,421	(9,057)	(19,139)
Accounts payable	8,177	2,076	(2,586)
Accrued compensation	1,248	9,445	(414)
Deferred revenue	(15,314)	8,736	(2,967)
Accrued liabilities	6,717	3,442	(8,493)
Other liabilities	(21,245)	18,045	417
Net cash provided by operating activities	279,465	288,425	175,973
Cash flows relating to investing activities			
Acquisition of businesses, net of cash acquired	(69,151)	(11,584)	(30,862)
Capital expenditures	(197,081)	(227,036)	(181,747)
Purchases of marketable securities	(6,439)	(299,408)	(207,900)
Proceeds from sale of marketable securities	45,444	334,546	122,981
Other, net	51	2,668	130
Net cash used in investing activities	(227,176)	(200,814)	(297,398)
Cash flows relating to financing activities			
Proceeds from long-term debt and revolving credit agreement	102,000		440,300
Payments on long-term debt, capital lease obligation and revolving credit agreement	(36,540)	(64,545)	(170,842)
Purchase of call options			(98,110)
Proceeds from exercises of stock options and warrants	28,490	53,977	22,900
Proceeds from issuance of warrants			65,423
Excess tax benefit from exercises of employee stock options	3,788	7,150	6,540
Purchase of treasury stock	(115,058)	(41,617)	(249,958)
Other, net		(1,392)	(10,685)
Net cash provided by (used in) financing activities	(17,320)	(46,427)	5,568
Discontinued operations			
Net cash provided by (used in) operating activities	484	(4,177)	(11,603)
Net cash provided by investing activities		30	189,406
Net cash used in financing activities			(182)
Net cash provided by (used in) discontinued operations	484	(4,147)	177,621

Effect of exchange rate changes on cash and cash equivalents	(17,310)	13,032	(1,205)
Net change in cash and cash equivalents	18,143	50,069	60,559
Cash and cash equivalents, beginning of period	225,449	175,380	114,821
Cash and cash equivalents, end of period	$ 243,592	$ 225,449	$ 175,380
Supplemental cash flow information			
Cash paid for interest	$ 14,186	$ 20,110	$ 22,992
Cash paid for taxes	$ 43,157	$ 38,448	$ 93,109
Supplemental non-cash investing activities information			
Capitalized interest	$ 2,486	$ 4,716	$ 4,107

See Notes to Consolidated Financial Statements.

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CHARLES RIVER LABORATORIES INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(dollars in thousands)

	Total	Accumulated (Deficit) Earnings	Accumulated Other Comprehensive Income	Common Stock	Capital in Excess of Par	Treasury Stock	Unearned Compensation	
nce at ember 31, 5	$ 1,827,013	$ 78,906	$ 8,540	$ 724	$ 1,777,625	$ (17,997)	$	(20,7
mponents of mprehensive ome, net of								
t (loss)	(55,783)	(55,783)						
reign rrency nslation ustment	12,335		12,335					
nimum nsion liability ustment	(195)		(195)					
realized gain marketable urities	11		11					
otal mprehensive come	(43,632)							
justment to tially apply AS No. 158, of tax	480		480					
benefit ociated with k issued er employee mpensation ns	5,714				5,714			
rcise of rants	79				79			
uance of stock er employee mpensation ns	22,821			10	22,811			
quisition of sury shares	(249,958)					(249,958)		
ck-based mpensation	21,866				21,866			
chase of ge on vertible debt	(98,110)				(98,110)			
uance of rants	65,423				65,423			
ferred tax ets	43,515				43,515			
versal of arned mpensation					(20,785)		20,785	t-family:inherit;font-size:10pt;color:#000000;text-decoration:none;">June 3 2014 and 201

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The following table presents a summary of held-to-maturity investment securities that had an unrealized loss:

(Dollars in thousands)	Less than 12 Months			12 Months or More			Total	
	Fair Value	Unrealized Loss	No. of Securities	Fair Value	Unrealized Loss	No. of Securities	Fair Value	Unrealized Loss
June 30, 2014								
Obligations of:								
States and political subdivisions	$—	$—	—	$325	$7	1	$325	$7
Residential mortgage-backed securities	—	—	—	18,722	703	6	18,722	703
Commercial mortgage-backed securities	—	—	—	6,669	24	1	6,669	24
Total	$—	$—	—	$25,716	$734	8	$25,716	$734
December 31, 2013								
Obligations of:								
States and political subdivisions	$321	$12	1	$—	$—	—	$321	$12
Residential mortgage-backed securities	$31,341	$2,908	7	$1,181	$133	1	$32,522	$3,041
Commercial mortgage-backed securities	6,547	203	1	—	—	—	6,547	203
Total	$38,209	$3,123	9	$1,181	$133	1	$39,390	$3,256

The table below presents the amortized cost, fair value and weighted-average yield of held-to-maturity securities by contractual maturity at June 30, 2014. The average yields are based on the amortized cost. In some cases, the issuers may have the right to call or prepay obligations without call or prepayment penalties prior to the contractual maturity date. Rates are calculated on a fully tax-equivalent basis using a 35% federal income tax rate.

(Dollars in thousands)	Within 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Total
Amortized cost					
Obligations of:					
States and political subdivisions	$—	$—	$331	$3,514	$3,845
Residential mortgage-backed securities	—	—	517	37,249	37,766
Commercial mortgage-backed securities	—	—	—	7,765	7,765
Total held-to-maturity securities	$—	$—	$848	$48,528	$49,376
Fair value					
Obligations of:					
States and political subdivisions	$—	$—	$325	$3,916	$4,241
Residential mortgage-backed securities	—	—	510	36,745	37,255
Commercial mortgage-backed securities	—	—	—	7,743	7,743
Total held-to-maturity securities	$—	$—	$835	$48,404	$49,239
Total average yield	—	%—	%2.61	%2.74	%2.73 %

Pledged Securities

Peoples had pledged available-for-sale investment securities with carrying values of $335.9 million and $303.8 million at June 30, 2014 and December 31, 2013, respectively, and held-to-maturity investment securities with carrying values of $23.1 million and $21.4 million at June 30, 2014 and December 31, 2013, respectively, to secure public and trust department deposits, and repurchase agreements in accordance with federal and state requirements. Peoples also pledged available-for-sale investment securities with carrying values of $14.9 million and $16.2 million at June 30, 2014 and December 31, 2013, respectively, and held-to-maturity securities with carrying

values of $25.2 million and $25.9 million at June 30, 2014 and December 31, 2013, respectively, to secure additional borrowing capacity at the Federal Home Loan Bank of Cincinnati ("FHLB") and the Federal Reserve Bank of Cleveland ("FRB").

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Note 4. Loans

Peoples' loan portfolio has consisted of various types of loans originated primarily as a result of lending opportunities within Peoples' primary market areas of northeastern, central and southeastern Ohio, west central West Virginia, and northeastern Kentucky. The major classifications of loan balances, excluding loans held for sale, were as follows:

(Dollars in thousands)	June 30, 2014	December 31, 2013
Commercial real estate, construction	$56,421	$47,539
Commercial real estate, other	463,734	450,170
Commercial real estate	520,155	497,709
Commercial and industrial	254,561	232,754
Residential real estate	314,190	268,617
Home equity lines of credit	61,838	60,076
Consumer	163,326	135,018
Deposit account overdrafts	5,282	2,060
Loans, net of deferred fees and costs	$1,319,352	$1,196,234

Peoples has acquired various loans through business combinations for which there was, at acquisition, evidence of deterioration of credit quality since origination, and for which it was probable that all contractually required payments would not be collected. The carrying amounts of these loans included in the loan balances above are summarized as follows:

(Dollars in thousands)	June 30, 2014	December 31, 2013
Commercial real estate	$1,611	$1,078
Commercial and industrial	574	188
Residential real estate	3,480	1,507
Consumer	101	9
Total outstanding balance	$5,766	$2,782
Net carrying amount	$4,237	$1,875

Changes in the accretable yield for the six months ended June 30, 2014 were as follows:

(Dollars in thousands)	Accretable Yield
Balance, December 31, 2013	$1,654
Additions:	
Midwest	1,102
Accretion	(570)
Balance, June 30, 2014	$2,186

Peoples has pledged certain loans secured by 1-4 family and multifamily residential mortgages under a blanket collateral agreement to secure borrowings from the FHLB. The amount of such pledged loans totaled $264.3 million and $259.1 million at June 30, 2014 and December 31, 2013, respectively. Peoples also had pledged commercial loans to secure borrowings with the FRB. The outstanding balances of these loans totaled $194.0 million and $113.0 million at June 30, 2014 and December 31, 2013, respectively.

Nonaccrual and Past Due Loans

A loan is considered past due if any required principal and interest payments have not been received as of the date such payments were required to be made under the terms of the loan agreement. A loan may be placed on nonaccrual status regardless of whether or not such loan is considered past due.

The recorded investments in loans on nonaccrual status and accruing loans delinquent for 90 days or more were as follows:

(Dollars in thousands)	Nonaccrual Loans		Accruing Loans 90+ Days Past Due	
	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013

Commercial real estate, construction	$96	$96	$—	$—
Commercial real estate, other	3,190	3,717	1,138	—
Commercial real estate	3,286	3,813	1,138	—
Commercial and industrial	806	708	903	—
Residential real estate	3,620	3,215	1,290	37
Home equity lines of credit	292	87	39	873
Consumer	—	58	20	—
Total	$8,004	$7,881	$3,390	$910

The following table presents the aging of the recorded investment in past due loans and leases:

	Loans Past Due				Current	Total
(Dollars in thousands)	30 - 59 days	60 - 89 days	90 + Days	Total	Loans	Loans
June 30, 2014						
Commercial real estate, construction	$—	$—	$96	$96	$56,325	$56,421
Commercial real estate, other	874	88	2,513	3,475	460,259	463,734
Commercial real estate	874	88	2,609	3,571	516,584	520,155
Commercial and industrial	50	432	1,662	2,144	252,417	254,561
Residential real estate	2,760	1,116	3,079	6,955	307,235	314,190
Home equity lines of credit	332	21	68	421	61,417	61,838
Consumer	908	177	21	1,106	162,220	163,326
Deposit account overdrafts	66	—	—	66	5,216	5,282
Total	$4,990	$1,834	$7,439	$14,263	$1,305,089	$1,319,352
December 31, 2013						
Commercial real estate, construction	$1,340	$—	$—	$1,340	$46,199	$47,539
Commercial real estate, other	432	679	1,249	2,360	447,810	450,170
Commercial real estate	1,772	679	1,249	3,700	494,009	497,709
Commercial and industrial	171	90	127	388	232,366	232,754
Residential real estate	5,445	1,509	1,452	8,406	260,211	268,617
Home equity lines of credit	254	65	929	1,248	58,828	60,076
Consumer	976	165	58	1,199	133,819	135,018
Deposit account overdrafts	47	—	—	47	2,013	2,060
Total	$8,665	$2,508	$3,815	$14,988	$1,181,246	$1,196,234

Credit Quality Indicators

As discussed in Note 1 of the Notes to the Consolidated Financial Statements included in Peoples' 2013 Form 10-K, Peoples categorizes the majority of its loans into risk categories based upon an established risk grading matrix using a scale of 1 to 8. A description of the general characteristics of the risk grades used by Peoples is as follows:

“Pass” (grades 1 through 4): Loans in this risk category involve borrowers of acceptable-to-strong credit quality and risk who have the apparent ability to satisfy their loan obligations. Loans in this risk grade would possess sufficient mitigating factors, such as adequate collateral or strong guarantors possessing the capacity to repay the debt if required, for any weakness that may exist.

“Watch” (grade 5): Loans in this risk grade are the equivalent of the regulatory definition of “Other Assets Especially Mentioned” classification. Loans in this category possess some credit deficiency or potential weakness, which requires a high level of management attention. Potential weaknesses include declining trends in operating earnings and cash flows and/or reliance on the secondary source of repayment. If left uncorrected, these potential weaknesses may result in noticeable deterioration of the repayment prospects for the asset or in Peoples' credit position.

“Substandard” (grade 6): Loans in this risk grade are inadequately protected by the borrower's current financial condition and payment capability or of the collateral pledged, if any. Loans so classified have one or more well-defined weaknesses that jeopardize the orderly repayment of debt. They are characterized by the distinct possibility that Peoples will sustain some loss if the deficiencies are not corrected.

“Doubtful” (grade 7): Loans in this risk grade have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or orderly repayment in full, on the basis of current existing facts, conditions and values, highly questionable and improbable. Possibility of loss is extremely high, but because of certain important and reasonably specific factors that may work to the advantage and strengthening of the exposure, its classification as an estimate loss is deferred until its more exact status may be determined.

“Loss” (grade 8): Loans in this risk grade are considered to be non-collectible and of such little value that their continuance as bankable assets is not warranted. This does not mean the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future. Charge-offs against the allowance for loan losses are taken in the period in which the loan becomes uncollectible. Consequently, Peoples typically does not maintain a recorded investment in loans within this category.

Consumer loans and other smaller-balance loans are evaluated and categorized as “substandard”, “doubtful” or “loss” based upon the regulatory definition of these classes and consistent with regulatory requirements. All other loans not evaluated individually, nor meeting the regulatory conditions to be categorized as described above, would be considered as being “not rated”.

The following table summarizes the risk category of Peoples' loan portfolio based upon the most recent analysis performed:

(Dollars in thousands)	Pass Rated (Grades 1 - 4)	Watch (Grade 5)	Substandard (Grade 6)	Doubtful (Grade 7)	Not Rated	Total Loans
June 30, 2014						
Commercial real estate, construction	$53,027	$—	$65	$—	$3,329	$56,421
Commercial real estate, other	429,819	11,456	20,580	—	1,879	463,734
Commercial real estate	482,846	11,456	20,645	—	5,208	520,155
Commercial and industrial	232,002	9,332	11,850	—	1,377	254,561
Residential real estate	23,800	2,560	10,227	38	277,565	314,190
Home equity lines of credit	825	—	1,181	—	59,832	61,838
Consumer	61	3	15	—	163,247	163,326
Deposit account overdrafts	—	—	—	—	5,282	5,282
Total	$739,534	$23,351	$43,918	$38	$512,511	$1,319,352
December 31, 2013						
Commercial real estate, construction	$43,407	$148	$68	$—	$3,916	$47,539
Commercial real estate, other	423,313	13,433	12,921	—	503	450,170
Commercial real estate	466,720	13,581	12,989	—	4,419	497,709
Commercial and industrial	212,193	6,013	14,006	542	—	232,754
Residential real estate	26,822	2,787	8,094	4	230,910	268,617
Home equity lines of credit	844	—	1,014	—	58,218	60,076
Consumer	50	5	24	—	134,939	135,018
Deposit account overdrafts	—	—	—	—	2,060	2,060
Total	$706,629	$22,386	$36,127	$546	$430,546	$1,196,234

Impaired Loans

The following table summarizes loans classified as impaired:

(Dollars in thousands)	Unpaid Principal Balance	Recorded Investment With Allowance	Recorded Investment Without Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
June 30, 2014							
Commercial real estate, construction	$96	$—	$96	$96	$—	$32	$3
Commercial real estate, other	5,351	985	2,229	3,214	158	3,182	6
Commercial real estate	5,447	$985	$2,325	$3,310	$158	$3,214	$9
Commercial and industrial	503	9	492	501	9	518	1

Residential real estate	3,335	—	3,294	3,294	—	2,876	95
Home equity lines of credit	500	—	498	498	—	403	6
Consumer	173	—	173	173	—	126	6
Total	$9,958	$994	$6,782	$7,776	$167	$7,137	$117
December 31, 2013							
Commercial real estate, construction	$—	$—	$—	$—	$—	$—	$—
Commercial real estate, other	4,970	1,150	1,729	2,879	83	4,586	6
Commercial real estate	4,970	$1,150	$1,729	$2,879	$83	$4,586	$6
Commercial and industrial	617	575	5	580	575	278	1
Residential real estate	3,498	—	3,280	3,280	—	2,800	86
Home equity lines of credit	347	—	347	347	—	327	12
Consumer	182	—	182	182	—	127	15
Total	$9,614	$1,725	$5,543	$7,268	$658	$8,118	$120

At June 30, 2014, Peoples' impaired loans shown in the table above included loans that were classified as troubled debt restructurings ("TDRs").

In assessing whether or not a borrower is experiencing financial difficulties, Peoples considers information currently available regarding the financial condition of the borrower. This information includes, but is not limited to, whether (i) the debtor is currently in payment default on any of its debt; (ii) a payment default is probable in the foreseeable future without the modification; (iii) the debtor has declared or is in the process of declaring bankruptcy; and (iv) the debtor's projected cash flow is insufficient to satisfy contractual payments due under the original terms of the loan without a modification.

Peoples considers all aspects of the modification to loan terms to determine whether or not a concession has been granted to the borrower. Key factors considered by Peoples include the debtor's ability to access funds at a market rate for debt with similar risk characteristics, the significance of the modification relative to the unpaid principal balance or collateral value of the debt, and the significance of a delay in the timing of payments relative to the original contractual terms of the loan. The most common concessions granted by Peoples generally include one or more modifications to the terms of the debt, such as (i) a reduction in the interest rate for the remaining life of the debt, (ii) an extension of the maturity date at an interest rate lower than the current market rate for new debt with similar risk, (iii) a temporary period of interest-only payments, and (iv) a reduction in the contractual payment amount for either a short period or the remaining term of the loan.

The following table summarizes the loans that were modified as a TDR during the three and six months ended June 30, 2014 and 2013.

	Three Months Ended			Six Months Ended			
		Recorded Investment (1)			Recorded Investment (1)		
	Number of Contracts	Pre-Modification	Post-Modification	At June 30, 2014	Number of Contracts	Pre-Modification	Post-Modification	At June 30, 2014
Commercial real estate, construction	1	$96	$ 96	$96	1	$96	$ 96	$96
Commercial real estate, other	—	$—	$ —	$—	1	$511	$ 511	$497
Residential real estate	10	$450	$ 449	$449	18	$946	$ 946	$935
Home equity lines of credit	2	$39	$ 39	$39	4	$86	$ 86	$86
Consumer	18	$76	$ 76	$76	20	$97	$ 97	$96

	Three Months Ended				Six Months Ended			
		Recorded Investment (1)				Recorded Investment (1)		
	Number of Contracts	Pre-Modification	Post-Modification	At June 30, 2013	Number of Contracts	Pre-Modification	Post-Modification	At June 30, 2013
Residential real estate	4	$174	$ 174	$174	10	$354	$ 354	$343
Home equity lines of credit	1	$30	$ 30	$30	2	$55	$ 55	$53
Consumer	12	$109	$ 109	$109	22	$178	$ 178	$164

(1) The amounts shown are inclusive of all partial paydowns and charge-offs. Loans modified in a TDR that were fully paid down, charged-off or foreclosed upon by period end are not reported.

The following table presents those loans for the six months ended June 30, 2014 and 2013 that were modified as a TDR during the last twelve months that subsequently defaulted (i.e., 90 days or more past due following a modification).

	June 30, 2014			June 30, 2013		
	Number of Contracts	Recorded Investment (1)	Impact on the Allowance for Loan Losses	Number of Contracts	Recorded Investment (1)	Impact on the Allowance for Loan Losses
Commercial real estate, other	—	$—	$—	1	$251	$—
Residential real estate	1	$40	$—	2	$70	$—
Home equity lines of credit	—	$—	$—	1	$24	$—
Total	1	$40	$—	4	$345	$—

(1) The amounts shown are inclusive of all partial paydowns and charge-offs. Loans modified in a TDR that were fully paid down, charged-off or foreclosed upon by period end are not reported.

Peoples had no additional commitments to lend additional funds to the related debtors whose terms have been modified in a TDR.

Allowance for Loan Losses

Changes in the allowance for loan losses in the periods ended June 30, were as follows:

(Dollars in thousands)	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Home Equity Lines of Credit	Consumer	Deposit Account Overdrafts	Total
Balance, January 1, 2014	$13,215	$2,174	$881	$343	$316	$136	$17,065
Charge-offs	—	(49)	(272)	(45)	(552)	(201)	(1,119)
Recoveries	208	59	117	12	351	100	847
Net recoveries (charge-offs)	208	10	(155)	(33)	(201)	(101)	(272)
Provision for loan losses	(3,156)	1,035	1,092	346	1,183	91	591
Balance, June 30, 2014	$10,267	$3,219	$1,818	$656	$1,298	$126	$17,384
Period-end amount allocated to:							
Loans individually evaluated for impairment	$158	$9	$—	$—	$—	$—	$167
Loans collectively evaluated for impairment	10,109	3,210	1,818	656	1,298	126	17,217
Ending balance	$10,267	$3,219	$1,818	$656	$1,298	$126	$17,384

Balance, January 1, 2013	$14,215	$1,733	$801	$479	$438	$145	$17,811
Charge-offs	(783)	(11)	(222)	(2)	(344)	(245)	(1,607)
Recoveries	2,806	21	261	13	236	99	3,436
Net recoveries (charge-offs)	2,023	10	39	11	(108)	(146)	1,829
Recovery of loan losses	(3,670)	445	165	—	410	123	(2,527)
Balance, June 30, 2013	$12,568	$2,188	$1,005	$490	$740	$122	$17,113
Period-end amount allocated to:							
Loans individually evaluated for impairment	$1,180	$266	$95	$—	$—	$—	$1,541
Loans collectively evaluated for impairment	11,388	1,922	910	490	740	122	15,572
Ending balance	$12,568	$2,188	$1,005	$490	$740	$122	$17,113

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Note 5. Stockholders' Equity

The following table details the progression in shares of Peoples' common and treasury stock during the six months ended June 30, 2014:

	Common Stock	Treasury Stock
Shares at December 31, 2013	11,206,576	600,794
Changes related to stock-based compensation awards:		
Release of restricted shares	57,704	14,034
Exercise of common stock options		(792)
Changes related to deferred compensation plan for Boards of Directors:		
Purchase of treasury stock		1,734
Reissuance of treasury stock		(7,910)
Shares issued under dividend reinvestment plan	9,170	
Common shares issued under compensation plan for Board of Directors		(4,564)
Issuance of common shares related to acquisitions:		
Midwest Bancshares, Inc.	256,282	
Shares at June 30, 2014	11,529,732	603,296

Under its Amended Articles of Incorporation, Peoples is authorized to issue up to 50,000 preferred shares, in one or more series, having such voting powers, designations, preferences, rights, qualifications, limitations and restrictions as determined by Peoples' Board of Directors. At June 30, 2014, Peoples had no preferred shares issued or outstanding.

Accumulated Other Comprehensive (Loss) Income

The following table details the change in the components of Peoples' accumulated other comprehensive (loss) income for the six months ended June 30, 2014:

(Dollars in thousands)	Unrealized (Loss) Gain on Securities	Unrecognized Net Pension and Postretirement Costs	Accumulated Other Comprehensive (Loss) Income
Balance, December 31, 2013	$(9,761)	$(3,483)	$(13,244)
Reclassification adjustments to net income:			
Realized gain on sale of securities, net of tax	(23)	—	(23)
Realized loss due to settlement and curtailment, net of tax	—	664	664
Other comprehensive income (loss), net of reclassifications and tax	10,333	(724)	9,609
Balance, June 30, 2014	$549	$(3,543)	$(2,994)

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Note 6. Employee Benefit Plans

Peoples sponsors a noncontributory defined benefit pension plan that covers substantially all employees hired before January 1, 2010. The plan provides retirement benefits based on an employee's years of service and compensation. For employees hired before January 1, 2003, the amount of postretirement benefit is based on the employee's average monthly compensation pay over the highest five consecutive years out of the employee's last ten years with Peoples while an eligible employee. For employees hired on or after January 1, 2003, the amount of postretirement benefit is based on 2% of the employee's annual compensation plus accrued interest. Effective January 1, 2010, the pension plan was closed to new entrants. Effective March 1, 2011, the accrual of pension plan benefits for all participants was frozen. Peoples recognized this freeze as a curtailment as of December 31, 2010 and March 1, 2011, under the terms of the pension plan. Peoples also provides post-retirement health and life insurance benefits to former employees and directors. Only those individuals who retired before January 27, 2012 were eligible for life insurance benefits. All retirees are eligible for health benefits; however, Peoples only pays 100% of the cost for those individuals who retired before January 1, 1993. For all others, the retiree is responsible for most, if not all, of the cost of health benefits. Peoples' policy is to fund the cost of the benefits as they arise.

The following tables detail the components of the net periodic cost for the plans:

	Pension Benefits			
	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2014	2013	2014	2013
Interest cost	$131	$133	$274	$266
Expected return on plan assets	(150)	(165)	(319)	(330)
Amortization of net loss	36	51	69	103
Settlement of benefit obligation	536	—	1,022	—
Net periodic cost	$553	$19	$1,046	$39

	Postretirement Benefits			
	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2014	2013	2014	2013
Interest cost	$2	$1	$3	$3
Amortization of net loss	(2)	(4)	(4)	(4)
Net periodic benefit	$—	$(3)	$(1)	$(1)

Under US GAAP, Peoples is required to recognize a settlement gain or loss when the aggregate amount of lump-sum distributions to participants equals or exceeds the sum of the service and interest cost components of the net periodic pension cost. The amount of settlement gain or loss recognized is the pro rata amount of the unrealized gain or loss existing immediately prior to the settlement. In general, both the projected benefit obligation and fair value of plan assets are required to be remeasured in order to determine the settlement gain or loss.

In the first six months of 2014, the total lump-sum distributions made to participants caused the total settlements to exceed the recognition threshold for settlement gains or losses. As a result, Peoples remeasured its pension obligation and plan assets as of April 1, 2014 as part of the calculation of the settlement loss recognized.

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The following table summarizes the change in pension obligation and funded status as a result of this remeasurement and the aggregate settlements for the six months ended June 30, 2014:

(Dollars in thousands)	As of December 31, 2013	June 30, 2014 Before Settlement	Impact of Settlements	After Settlements
Funded status:				
Projected benefit obligation	$14,723	$15,065	$(1,323)	$13,742
Fair value of plan assets	11,287	10,467	(1,323)	9,144
Funded status	$(3,436)	$(4,598)	$—	$(4,598)
Gross unrealized loss	$5,436	$6,089	$(536)	$5,553
Assumptions:				
Discount rate	4.30%	3.70%		3.70%
Expected return on plan assets	7.50%	7.50%		7.50%

Note 7. Stock-Based Compensation

Under the Peoples Bancorp Inc. Second Amended and Restated 2006 Equity Plan (the “2006 Equity Plan”), Peoples may grant, among other awards, nonqualified stock options, incentive stock options, restricted stock awards, stock appreciation rights and unrestricted share awards to employees and non-employee directors. The total number of shares available under the 2006 Equity Plan is 1,081,260. The maximum number of shares that can be issued for incentive stock options is 800,000 shares. Prior to 2007, Peoples granted nonqualified and incentive stock options to employees and nonqualified stock options to non-employee directors under the 2006 Equity Plan and predecessor plans. Since February 2007, Peoples has granted a combination of restricted shares and stock appreciation rights (“SARs”) to be settled in shares to employees and restricted shares to non-employee directors subject to the terms and conditions prescribed by the 2006 Equity Plan. In general, shares issued in connection with stock-based awards are issued from treasury shares to the extent available. If no treasury shares are available, shares are issued from authorized but unissued shares.

Stock Options

Under the provisions of the 2006 Equity Plan and predecessor stock option plans, the exercise price per share of any stock option granted may not be less than the grant date fair market value of the underlying shares. All stock options granted to both employees and non-employee directors expire ten years from the date of grant. The most recent stock option grants to employees and non-employee directors occurred in 2006. The stock options granted to employees vested three years after the grant date, while the stock options granted to non-employee directors vested six months after the grant date.

The following table summarizes the changes to Peoples' stock options for the six months ended June 30, 2014:

	Number of Shares Subject to Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at January 1	57,094	$ 27.96		
Exercised	792	24.07		
Expired	12,926	28.12		
Outstanding at June 30	43,376	$ 27.98	1.3 years	$3,000
Exercisable at June 30	43,376	$ 27.98	1.3 years	$3,000

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The following table summarizes Peoples' stock options outstanding at June 30, 2014:

Range of Exercise Prices			Options Outstanding & Exercisable		
			Shares Subject to Options Outstanding & Exercisable	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$23.59	to	$25.94	2,000	0.2 years	$ 25.94
$26.01	to	$27.74	15,136	0.6 years	26.93
$28.25	to	$28.26	15,040	1.6 years	28.25
$28.57	to	$30.00	11,200	1.8 years	29.40
Total			43,376	1.3 years	$ 27.98

Stock Appreciation Rights

SARs granted to employees have an exercise price equal to the fair market value of Peoples' shares on the date of grant and will be settled using shares of Peoples. Additionally, the SARs granted vested three years after the grant date and expire ten years from the date of grant. The most recent grant of SARs occurred in 2008. The following table summarizes the changes to Peoples' SARs for the six months ended June 30, 2014:

	Number of Shares Subject to SARs	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at January 1	21,292	$25.96		
Forfeited	—	—		
Outstanding at June 30	21,292	$25.96	3.2 years	$35,000
Exercisable at June 30	21,292	$25.96	3.2 years	$35,000

The following table summarizes Peoples' SARs outstanding at June 30, 2014:

Exercise Price	Number of Shares Subject to SARs Outstanding & Exercisable	Weighted-Average Remaining Contractual Life
$23.26	2,000	3.1 years
$23.77	10,582	3.6 years
$29.25	8,710	2.6 years
Total	21,292	3.2 years

Restricted Shares

Under the 2006 Equity Plan, Peoples may award restricted shares to officers, key employees and non-employee directors. In general, the restrictions on restricted shares awarded to non-employee directors expire after six months, while the restrictions on restricted shares awarded to employees expire after periods ranging from one to three years. In the first quarter of 2014, Peoples granted restricted shares subject to performance-based vesting to officers and key employees with restrictions that will lapse one to three years after the grant date provided that in order for the restricted common shares to vest on each of the three foregoing dates, Peoples must have reported positive net income and maintained a well capitalized status by regulatory standards in the year immediately preceding the vesting date. During the second quarter of 2014, Peoples granted restricted common shares to non-employee directors with a six month time-based vesting period, and certain key employees with a three year time-based vesting period.

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The following table summarizes the changes to Peoples' restricted shares for the six months ended June 30, 2014:

	Time-Based Vesting		Performance-Based Vesting	
	Number of Shares	Weighted-Average Grant Date Fair Value	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1	60,206	$ 17.18	85,254	$ 20.98
Awarded	4,900	24.32	83,514	21.68
Released	20,077	15.75	37,746	19.93
Forfeited	—	—	5,803	21.73
Outstanding at June 30	45,029	$ 18.60	125,219	$ 21.73

For the six months ended June 30, 2014, the total intrinsic value of restricted shares released was $1.3 million.

Stock-Based Compensation

Peoples recognized stock-based compensation expense, which is included as a component of Peoples' salaries and employee benefit costs, based on the estimated fair value of the awards on the grant date. The following table summarizes the amount of stock-based compensation expense and related tax benefit recognized:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2014	2013	2014	2013
Total stock-based compensation	$464	$386	$954	$683
Recognized tax benefit	(162)	(135)	(334)	(239)
Net expense recognized	$302	$251	$620	$444

Total unrecognized stock-based compensation expense related to unvested awards was $1.7 million at June 30, 2014, which will be recognized over a weighted-average period of 1.5 years.

Note 8. Earnings Per Share

The calculations of basic and diluted earnings per share were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except per share data)	2014	2013	2014	2013
Distributed earnings allocated to shareholders	$1,609	$1,490	$3,213	$2,764
Undistributed earnings allocated to shareholders	1,837	3,388	4,987	7,094
Net earnings allocated to shareholders	$3,446	$4,878	$8,200	$9,858
Weighted-average shares outstanding	10,755,509	10,576,643	10,696,129	10,566,508
Effect of potentially dilutive shares	124,581	20,390	111,559	17,875
Total weighted-average diluted shares outstanding	10,880,090	10,597,033	10,807,688	10,584,383
Earnings per share:				
Basic	$0.32	$0.46	$0.77	$0.93
Diluted	$0.32	$0.46	$0.76	$0.93
Anti-dilutive shares excluded from calculation:				
Stock options and SARs	52,587	86,986	57,303	103,438

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Note 9. Acquisitions

On May 30, 2014, Peoples completed its acquisition of Midwest Bancshares, Inc. ("Midwest") for total consideration of $12.6 million which was settled 50% in cash and 50% in Peoples' common shares. Midwest merged into Peoples and Midwest's wholly-owned subsidiary, First National Bank of Wellston, which operates two full-service branches in Wellston and Jackson, Ohio, merged into Peoples' wholly-owned subsidiary, Peoples Bank, National Association ("Peoples Bank"). The acquisition was accounted for as a business combination under the acquisition method of accounting under US GAAP. The assets purchased, liabilities assumed, and related identifiable intangible assets were recorded at their acquisition date fair values. Per the applicable accounting guidance for business combinations, these fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information relative to closing date fair values become available. The goodwill recognized will not be deductible for income tax purposes.

As a result of the Midwest acquisition, Peoples acquired loans of $59.7 million and deposits of $78.1 million after purchase accounting adjustments. The balances and operations related to the acquisition are included in Peoples' consolidated financial statements from the date of the acquisition, and did not materially impact Peoples' financial position, results of operations or cash flows for any period presented.

On April 4, 2014, Peoples entered into an Agreement and Plan of Merger (the "Ohio Heritage Agreement") with Ohio Heritage Bancorp, Inc. (“Ohio Heritage”). The Ohio Heritage Agreement calls for Ohio Heritage to merge into Peoples, and for Ohio Heritage's wholly-owned subsidiary, Ohio Heritage Bank, which operates six full-service branches in Coshocton, Newark, Heath, Mount Vernon and New Philadelphia, Ohio, to merge into Peoples' wholly-owned subsidiary, Peoples Bank. This transaction is expected to close during the third quarter of 2014.

On April 21, 2014, Peoples entered into an Agreement and Plan of Merger (the "North Akron Agreement") with North Akron Savings Bank (“North Akron”), which operates four full-service branches in Akron, Cuyahoga Falls, Munroe Falls and Norton, Ohio. The North Akron Agreement calls for North Akron to merge into Peoples’ wholly-owned subsidiary, Peoples Bank. This transaction is expected to close during the fourth quarter of 2014.

The following table is a preliminary summary of changes in goodwill and intangible assets during the period ended June 30, 2014:

(Dollars in thousands)	Goodwill	Gross Core Deposit	Gross Customer Relationships
Balance, December 31, 2013	$70,520	$8,760	$8,647
Acquired intangible assets:			
Midwest	1,323	976	—
Balance, June 30, 2014	$71,843	$9,736	$8,647

(Dollars in thousands)	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
June 30, 2014			
Core deposits	$9,736	$(7,089)	$2,647
Customer relationships	8,647	(6,075)	2,572
Total acquired intangible assets	$18,383	$(13,164)	$5,219
Servicing rights			2,211
Total other intangible assets			$7,430

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

SELECTED FINANCIAL DATA

The following data should be read in conjunction with the Unaudited Consolidated Financial Statements and the Management's Discussion and Analysis that follows:

	At or For the Three Months Ended June 30,		At or For the Six Months Ended June 30,	
	2014	2013	2014	2013
SIGNIFICANT RATIOS				
Return on average stockholders' equity	5.91%	8.74%	7.20%	8.96%
Return on average assets	0.67%	1.03%	0.80%	1.05%
Net interest margin	3.39%	3.13%	3.37%	3.11%
Efficiency ratio (a)	75.58%	71.71%	73.35%	71.66%
Pre-provision net revenue to average assets (b)	1.11%	1.25%	1.24%	1.25%
Average stockholders' equity to average assets	11.29%	11.82%	11.18%	11.70%
Average loans to average deposits	78.82%	68.87%	77.90%	67.10%
Dividend payout ratio	46.98%	30.73%	39.43%	28.23%
ASSET QUALITY RATIOS				
Nonperforming loans as a percent of total loans (c)(d)	0.86%	1.17%	0.86%	1.17%
Nonperforming assets as a percent of total assets (c)(d)	0.57%	0.64%	0.57%	0.64%
Nonperforming assets as a percent of total loans and other real estate owned (c)(d)	0.93%	1.18%	0.93%	1.18%
Allowance for loan losses as a percent of loans, net of deferred fees and costs (c)(d)	1.32%	1.66%	1.32%	1.66%
Allowance for loan losses to nonperforming loans (c)(d)	152.57%	141.11%	152.57%	141.11%
Provision for (recovery of) loan losses as a percent of average total loans	0.19%	(0.58)%	0.10%	(0.51)%
Net charge-offs (recoveries) as a percentage of average total loans (annualized)	0.02%	(0.45)%	0.04%	(0.37)%
CAPITAL RATIOS (d)				
Tier 1	12.33%	14.17%	12.33%	14.17%
Total (Tier 1 and Tier 2)	13.65%	15.54%	13.65%	15.54%
Tier 1 leverage	8.76%	9.04%	8.76%	9.04%
Tangible equity to tangible assets (e)	7.92%	8.07%	7.92%	8.07%
PER SHARE DATA				
Earnings per share – Basic	$0.32	$0.46	$0.77	$0.93
Earnings per share – Diluted	0.32	0.46	0.76	0.93
Cash dividends declared per share	0.15	0.14	0.30	0.26
Book value per share (d)	22.36	20.71	22.36	20.71
Tangible book value per share (d)(e)	$15.10	$13.94	$15.10	$13.94
Weighted-average number of shares outstanding – Basic	10,755,509	10,576,643	10,696,129	10,566,508
Weighted-average number of shares outstanding – Diluted	10,880,090	10,597,033	10,807,688	10,584,383
Shares outstanding at end of period	10,926,436	10,583,161	10,926,436	10,583,161

(a) Non-interest expense (less intangible asset amortization) as a percentage of fully tax-equivalent net interest income plus non-interest income (excluding gains or losses on investment securities and asset disposals and other transactions).

(b) These amounts represent non-GAAP financial measures since they exclude the provision for (recovery of) loan losses and all gains and losses included in earnings. Additional information regarding the calculation of these measures can be found later in this section under the caption “Pre-Provision Net Revenue”.

(c) Nonperforming loans include loans 90 days past due and accruing, renegotiated loans and nonaccrual loans. Nonperforming assets include nonperforming loans and other real estate owned.

(d) Data presented as of the end of the period indicated.

(e) These amounts represent non-GAAP financial measures since they exclude the balance sheet impact of intangible assets acquired through acquisitions on both total stockholders’ equity and total assets. Additional information regarding the calculation of these measures can be found later in this discussion under the caption “Capital/Stockholders’ Equity”.

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Forward-Looking Statements

Certain statements in this Form 10-Q, which are not historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act , Section 21E of the Exchange Act, and the Private Securities Litigation Reform Act of 1995. Words such as “anticipate”, “estimates”, “may”, “feels”, “expects”, “believes”, “plans”, “will”, “would”, “should similar expressions are intended to identify these forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially. Factors that might cause such a difference include, but are not limited to:

(1) the success, impact, and timing of the implementation of Peoples' business strategies, including the successful integration of the recently completed acquisitions and the expansion of consumer lending activity;

(2) Peoples' ability to complete and, if completed, successfully integrate future acquisitions, including the pending acquisitions of Ohio Heritage and North Akron;

(3) competitive pressures among financial institutions or from non-financial institutions may increase significantly, including product and pricing pressures and Peoples' ability to attract, develop and retain qualified professionals;

(4) changes in the interest rate environment due to economic conditions and/or the fiscal policies of the U.S. government and Board of Governors of the Federal Reserve System ("Federal Reserve Board"), which may adversely impact interest margins and interest rate sensitivity;

(5) changes in prepayment speeds, loan originations and charge-offs, which may be less favorable than expected and adversely impact the amount of interest income generated;

(6) adverse changes in the economic conditions and/or activities, including, but not limited to, impacts from the implementation of the Budget Control Act of 2011 and the American Taxpayer Relief Act of 2012, as well as continuing economic uncertainty in the U.S., the European Union, and other areas, which could decrease sales volumes and increase loan delinquencies and defaults;

(7) legislative or regulatory changes or actions, including in particular the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the regulations promulgated and to be promulgated thereunder by the Office of the Comptroller of the Currency ("OCC"), the Federal Reserve Board and the Consumer Financial Protection Bureau, which may subject Peoples, its subsidiaries, or one or more acquired companies to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses;

(8) deterioration in the credit quality of Peoples' loan portfolio, which may adversely impact the provision for loan losses;

(9) changes in accounting standards, policies, estimates or procedures, which may adversely affect Peoples' reported financial condition or results of operations;

(10) adverse changes in the conditions and trends in the financial markets, including political developments, which may adversely affect the fair value of securities within Peoples' investment portfolio, the interest rate sensitivity of Peoples' consolidated balance sheet, and the income generated by Peoples' trust and investment activities;

(11) Peoples' ability to receive dividends from its subsidiaries;

(12) Peoples' ability to maintain required capital levels and adequate sources of funding and liquidity;

(13) the impact of new minimum capital thresholds established as a part of the implementation of Basel III;

(14) the impact of larger or similar sized financial institutions encountering problems, which may adversely affect the banking industry and/or Peoples' business generation and retention, funding and liquidity;

(15) the costs and effects of regulatory and legal developments, including the outcome of potential regulatory or other governmental inquiries and legal proceedings and results of regulatory examinations;

(16) Peoples' ability to secure confidential information through the use of computer systems and telecommunications networks, including those of Peoples' third-party vendors and other service providers, may prove inadequate, which could adversely affect customer confidence in Peoples and/or result in Peoples incurring a financial loss;

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(17) the overall adequacy of Peoples' risk management program; and

(18) other risk factors relating to the banking industry or Peoples as detailed from time to time in Peoples' reports filed with the Securities and Exchange Commission ("SEC"), including those risk factors included in the disclosure under "ITEM 1A. RISK FACTORS" of Peoples' 2013 Form 10-K.

All forward-looking statements speak only as of the filing date of this Form 10-Q and are expressly qualified in their entirety by the cautionary statements. Although management believes the expectations in these forward-looking statements are based on reasonable assumptions within the bounds of management's knowledge of Peoples' business and operations, it is possible that actual results may differ materially from these projections. Additionally, Peoples undertakes no obligation to update these forward-looking statements to reflect events or circumstances after the filing date of this Form 10-Q or to reflect the occurrence of unanticipated events except as may be required by applicable legal requirements. Copies of documents filed with the SEC are available free of charge at the SEC's website at www.sec.gov and/or from Peoples' website – www.peoplesbancorp.com under the "Investor Relations" section.

This discussion and analysis should be read in conjunction with the audited Consolidated Financial Statements, and Notes thereto, contained in Peoples' 2013 Form 10-K, as well as the Unaudited Consolidated Financial Statements, Notes to the Unaudited Consolidated Financial Statements, ratios, statistics and discussions contained elsewhere in this Form 10-Q.

Business Overview

The following discussion and analysis of Peoples' Unaudited Consolidated Financial Statements is presented to provide insight into management's assessment of the financial condition and results of operations.

Peoples offers diversified financial products and services through 50 financial service locations and 50 ATMs in northeastern, central and southeastern Ohio, west central West Virginia and northeastern Kentucky through its financial service units – Peoples Bank and Peoples Insurance Agency, LLC ("Peoples Insurance"), a subsidiary of Peoples Bank. Peoples Bank is subject to regulation and examination primarily by the OCC and secondarily by the Federal Reserve Board and the Federal Deposit Insurance Corporation (the "FDIC").

Peoples' products and services include traditional banking products, such as deposit accounts, lending products and trust services. Peoples provides services through traditional offices, ATMs, and telephone and internet-based banking. Peoples also offers a complete array of insurance products and makes available custom-tailored fiduciary and wealth management services. Brokerage services are offered by Peoples exclusively through an unaffiliated registered broker-dealer.

Critical Accounting Policies

The accounting and reporting policies of Peoples conform to US GAAP and to general practices within the financial services industry. The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could materially differ from those estimates. Management has identified the accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to understanding Peoples' Unaudited Consolidated Financial Statements, and Management's Discussion and Analysis at June 30, 2014, which were unchanged from the policies disclosed in Peoples' 2013 Form 10-K.

Summary of Recent Transactions and Events

The following is a summary of recent transactions and events that have impacted or are expected to impact Peoples' results of operations or financial condition:

On April 21, 2014, Peoples entered into the North Akron Agreement. The North Akron Agreement calls for North Akron, which operates four full-service branches in Akron, Cuyahoga Falls, Munroe Falls and Norton, Ohio, to merge into Peoples' wholly-owned subsidiary, Peoples Bank. Under the terms of the North Akron Agreement, shareholders of North Akron will receive $7,655 per share, or approximately $20.1 million total value, with 80% of the total consideration to be paid in Peoples' shares and the remaining 20% to be paid in cash. The exchange ratio for the stock component of the transaction will be determined based on the Peoples' average closing stock price during the 20 consecutive trading days immediately preceding the closing of the transaction. The North Akron transaction is expected to be completed during the fourth quarter of 2014, pending adoption of the North Akron Agreement by the shareholders of North Akron, the satisfaction of

various closing conditions, including the accuracy of the representations and warranties of each party (subject to certain exceptions), the performance in all material respects by each party of its obligations under the North Akron Agreement, and other conditions customary for transactions of this type. The North Akron transaction is expected to add $0.06 to $0.08 to Peoples' annual earnings per share starting in 2015. One-time acquisition costs will more than offset the incremental earnings in 2014.

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On April 4, 2014, Peoples entered into the Ohio Heritage Agreement. The Ohio Heritage Agreement calls for Ohio Heritage to merge into Peoples, and for Ohio Heritage's wholly-owned subsidiary, Ohio Heritage Bank, an Ohio-chartered savings bank, which operates six full-service branches in Coshocton, Newark, Heath, Mount Vernon and New Philadelphia, Ohio, to merge into Peoples' wholly-owned subsidiary, Peoples Bank. Under the terms of the Ohio Heritage Agreement, shareholders of Ohio Heritage will have the right to receive merger consideration equal to $110.00 per share, or approximately $37.6 million total value, with 85% of the total consideration to be paid in Peoples' shares and the remaining 15% to be paid in cash. The exchange ratio for the Peoples shares component of the consideration will be determined based on Peoples' volume weighted-average closing share price during the 20 consecutive trading days immediately preceding the closing of the merger. The Ohio Heritage transaction is expected to be completed during the third quarter of 2014, pending adoption of the Ohio Heritage Agreement by the shareholders of Ohio Heritage, the satisfaction of various closing conditions, including the accuracy of the representations and warranties of each party (subject to certain exceptions), the performance in all material respects by each party of its obligations under the Ohio Heritage Agreement, and other conditions customary for transactions of this type. The Ohio Heritage transaction is expected to add $0.10 to $0.12 to Peoples' annual earnings per share starting in 2015. One-time acquisition costs are expected to offset incremental earnings in 2014.

At the close of business on May 30, 2014, Peoples completed the acquisition of Midwest and its full services offices in Wellston and Jackson, Ohio. Under the terms of the agreement, Peoples paid $65.50 of consideration, or $12.6 million, of which 50% was paid in cash and the remaining 50% in Peoples' shares. The acquisition added $59.7 million of loans and $78.1 million of deposits.

At the close of business on October 11, 2013, Peoples Bank completed the acquisition of Ohio Commerce Bank ("Ohio Commerce") and its single full-service office in Beachwood, Ohio. Under the terms of the agreement, Peoples Bank paid $13.75 in cash for each share of Ohio Commerce stock for a total cash consideration of $16.5 million. The acquisition added $96.6 million of loans and $110.9 million of deposits.

Peoples periodically has taken actions to reduce interest rate exposure within the investment portfolio and the entire balance sheet, which have included the sale of low-yielding investment securities and repayment of high-cost borrowings. These actions included the sale of $68.8 million of investment securities, primarily low or volatile yielding residential mortgage-backed securities, during the first quarter of 2013. Some of the proceeds from these investment sales were reinvested in securities during the first quarter with the remaining reinvested early in the second quarter of 2013. During the first half of 2014, in an effort to reduce the relative size of the portfolio, Peoples used the cash flow generated from the investment portfolio to fund loan growth.

Peoples' net interest income and margin are impacted by changes in market interest rates based upon actions taken by the Federal Reserve Board either directly or through its Open Market Committee. These actions include changing its target Federal Funds Rate (the interest rate at which banks lend money to each other), Discount Rate (the interest rate charged to banks for money borrowed from the Federal Reserve Bank) and longer-term market interest rates (primarily U.S. Treasury securities). Longer-term market interest rates also are affected by the demand for U.S. Treasury securities. The resulting changes in the yield curve slope have a direct impact on reinvestment rates for Peoples' earning assets.

The Federal Reserve Board has maintained its target Federal Funds Rate at a historically low level of 0% to 0.25% since December 2008 and has maintained the Discount Rate at 0.75% since December 2010. The Federal Reserve Board has indicated the possibility these short-term rates could start to be raised as early as 2015.

From late 2008 until year-end 2012, the Federal Reserve Board took various actions to lower longer-term market interest rates as a means of stimulating the economy – a policy commonly referred to as “quantitative easing”. These actions included the buying and selling of mortgage-backed and other debt securities through its open market operations. In December 2013, the Federal Reserve Board announced plans to taper its quantitative easing efforts. As a result, the slope of the U.S. Treasury yield curve has fluctuated significantly. Substantial flattening occurred in late 2008, in mid-2010 and early third quarter of 2011 through 2012, while moderate steepening occurred in the second half of 2009, late 2010 and mid-2013. The curve has remained relatively steep since mid-2013, primarily as a reaction to the Federal Reserve Board's announcement of a reduction in monthly asset purchases and generally improving economic conditions.

The impact of these transactions and events, where material, is discussed in the applicable sections of this Management's Discussion and Analysis.

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EXECUTIVE SUMMARY

Net income for the quarter ended June 30, 2014 was $3.5 million, or $0.32 per diluted share, compared to $4.9 million and $0.46 per diluted share a year ago, and $4.8 million or $0.44 per diluted share in the first quarter of 2014. The decreased earnings in the second quarter of 2014 were largely due to higher provision for loan losses compared to prior periods and increased non-interest expenses.

Peoples' provision for loan losses for the three months ended June 30, 2014 was $583,000, compared to recoveries of loan losses of $1.5 million during the three months ended June 30, 2013 and nominal provision for loan losses for the three months ended March 31, 2014. For the six months ended June 30, 2014, provision for loan losses was $591,000 compared to recoveries of loan losses of $2.5 million in 2013. The increase in provision for loan losses was a result of higher loan growth in recent quarters. Net charge-offs for the second quarter of 2014 were $0.1 million compared to net recoveries of $1.1 million in the second quarter of 2013 and net charge-offs of $0.2 million in the first quarter of 2014. Asset quality metrics remained favorable during the second quarter of 2014.

Net interest income was $16.0 million in the second quarter of 2014, compared to $13.2 million for the second quarter of 2013, while net interest margin was 3.39% and 3.13%, respectively. For the six months ended June 30, 2014, net interest income was $31.5 million, compared to $26.1 million in 2013. The improvement over the prior year was driven by an increase in earning assets due to higher loan balances, stability in the asset yields and the change in asset mix. The acquired balances and accretion income from the Midwest acquisition added approximately 3 basis points of net interest margin for the second quarter of 2014. Compared to the prior year second quarter, net interest margin expanded 26 basis points from earning asset growth and accretion income from completed acquisitions.

Total non-interest income was up 5% in the second quarter and 9% for the first half of 2014, compared to the same periods in 2013, due largely to higher insurance income. During the second quarter of 2014, insurance income benefited from increased property and casualty commissions resulting from higher customer retention rates and referrals from other lines of business. In addition, deposit account service charges, and trust and investment income both grew 5% from the linked quarter and 9% from the prior year second quarter. Mortgage banking income continues to be pressured as refinancing activity has declined in response to the higher long-term interest rates, leading to a $545,000 decline year-to-date.

Non-interest expenses were 6% higher than the linked quarter and 22% higher than the prior year second quarter. This increase included $1.3 million of acquisition-related costs, consisting primarily of deconversion costs, and professional and legal fees, during the second quarter of 2014, compared to $150,000 in the linked quarter and $37,000 in the prior year second quarter. Salaries and employee benefit costs grew 4% over the linked quarter and 26% over the prior year second quarter as employee medical benefit plan costs increased due to higher claim activity and pension settlement charges of $536,000 recognized in the second quarter of 2014. Pension settlement charges during the first half of 2014 were $1.0 million, while there were no pension settlement charges recognized in the first half of 2013.

At June 30, 2014, total assets were $2.16 billion, up $104.8 million from year-end 2013. This increase was primarily the result of the Midwest acquisition, coupled with organic loan growth of $63.4 million since December 31, 2013. The allowance for loan losses was $17.4 million, or 1.32% of loans (net of deferred fees and costs), compared to $17.1 million and 1.43% at December 31, 2013.

Total liabilities were $1.92 billion at June 30, 2014, up $82.1 million since year-end 2013. Retail deposit balances grew 6%, or $88.6 million since year-end, primarily driven by the deposits acquired from Midwest of $78.1 million. Non-interest bearing deposits increased 4% or $16.5 million from December 31, 2013 primarily due to the Midwest acquisition. Peoples continues to focus on its strategy of reducing high-cost funding with increases in low-cost core deposits.

At June 30, 2014, total stockholders' equity was $244.3 million, up $22.7 million since December 31, 2013. During the second quarter of 2014, Peoples issued $6.3 million of common shares in consideration for the Midwest acquisition. In addition, earnings exceeded dividends declared in 2014 and the fair value of the available-for-sale investment portfolio increased. Regulatory capital ratios remained significantly higher than "well capitalized" minimums. Peoples' Tier 1 Common Capital ratio remained stable at 12.33% at June 30, 2014, versus 12.42% at December 31, 2013, while the Total Risk-Based Capital ratio was 13.65% versus 13.78% at December 31, 2013. In

addition, Peoples' tangible equity to tangible asset ratio was 7.92% and tangible book value per share was $15.10 at June 30, 2014, versus 7.26% and $13.57 at December 31, 2013, respectively.

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RESULTS OF OPERATIONS

Net Interest Income

Net interest income, the amount by which interest income exceeds interest expense, remains Peoples' largest source of revenue. The amount of net interest income earned by Peoples each quarter is affected by various factors, including changes in market interest rates due to the Federal Reserve Board's monetary policy, the level and degree of pricing competition for both loans and deposits in Peoples' markets, and the amount and composition of Peoples' earning assets and interest-bearing liabilities.

The following tables detail Peoples' average balance sheets for the periods presented:

	For the Three Months Ended											
	June 30, 2014				March 31, 2014				June 30, 2013			
(Dollars in thousands)	Average Balance	Income/ Expense	Yield/Cost		Average Balance	Income/ Expense	Yield/Cost		Average Balance	Income/ Expense	Yield/Cost	
Short-term investments	$7,076	$(44)	(2.49)	%	$7,058	$20	1.15	%	$11,399	$25	0.88	%
Other long-term investments	2,170	2	0.37	%	2,254	3	0.54	%	—	—	—	%
Investment Securities (1):												
Taxable	610,221	4,185	2.74	%	623,444	4,383	2.81	%	657,644	4,202	2.56	%
Nontaxable (2)	58,494	687	4.70	%	51,867	641	4.94	%	50,978	607	4.76	%
Total investment securities	668,715	4,872	2.91	%	675,311	5,024	2.98	%	708,622	4,809	2.71	%
Loans (3):												
Commercial real estate, construction	53,615	514	3.79	%	51,839	498	3.84	%	27,591	307	4.40	%
Commercial real estate, other	465,723	5,269	4.48	%	454,107	5,114	4.50	%	382,994	4,460	4.61	%
Commercial and industrial	240,770	2,691	4.42	%	236,741	2,570	4.34	%	183,933	1,856	3.99	%
Residential real estate (4)	286,604	3,311	4.62	%	270,739	3,069	4.53	%	247,100	2,918	4.72	%
Home equity lines of credit	60,349	562	3.72	%	60,029	545	3.63	%	50,902	507	3.98	%
Consumer	155,457	1,771	4.57	%	141,209	1,614	4.73	%	116,995	1,528	5.35	%
Total loans	1,262,518	14,118	4.45	%	1,214,664	13,410	4.43	%	1,009,515	11,576	4.57	%
Less: Allowance for loan losses	(17,126)				(17,228)				(17,866)			
Net loans	1,245,392	14,118	4.51	%	1,197,436	13,410	4.49	%	991,649	11,576	4.64	%
Total earning assets	1,923,353	18,948	3.92	%	1,882,059	18,457	3.93	%	1,711,670	16,410	3.82	%
Intangible assets	77,917				77,448				71,081			
Other assets	89,681				91,095				128,237			
Total assets	$2,090,951				$2,050,602				$1,910,988			

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	For the Three Months Ended								
	June 30, 2014			March 31, 2014			June 30, 2013		
(Dollars in thousands)	Average Balance	Income/ Expense	Yield/Cost	Average Balance	Income/ Expense	Yield/Cost	Average Balance	Income/ Expense	Yield/Cost
Deposits:									
Savings accounts	$230,431	$31	0.05 %	$220,935	$30	0.06 %	$199,065	$27	0.05 %
Governmental deposit accounts	159,476	113	0.28 %	149,057	123	0.33 %	147,824	168	0.46 %
Interest-bearing demand accounts	138,745	29	0.08 %	137,026	28	0.08 %	124,199	25	0.08 %
Money market accounts	268,480	107	0.16 %	278,413	111	0.16 %	266,602	93	0.14 %
Brokered deposits	42,976	382	3.57 %	47,335	436	3.74 %	51,952	468	3.61 %
Retail certificates of deposit	356,286	803	0.90 %	360,457	840	0.95 %	350,141	1,017	1.17 %
Total interest-bearing deposits	1,196,394	1,465	0.49 %	1,193,223	1,568	0.53 %	1,139,783	1,798	0.63 %
Borrowed Funds:									
Short-term FHLB advances	56,341	14	0.10 %	63,733	16	0.10 %	35,462	9	0.10 %
Retail repurchase agreements	55,612	23	0.17 %	39,141	15	0.15 %	33,340	13	0.16 %
Total short-term borrowings	111,953	37	0.13 %	102,874	31	0.12 %	68,802	22	0.13 %
Long-term FHLB advances	62,108	523	3.38 %	62,380	521	3.39 %	64,237	543	3.39 %
Wholesale repurchase agreements	40,000	367	3.67 %	40,000	363	3.63 %	40,000	367	3.67 %
Other borrowings	17,943	179	3.95 %	19,137	188	3.93 %	22,690	226	3.94 %
Total long-term borrowings	120,051	1,069	3.56 %	121,517	1,072	3.55 %	126,927	1,136	3.58 %
Total borrowed funds	232,004	1,106	1.91 %	224,391	1,103	1.98 %	195,729	1,158	2.36 %
Total interest-bearing liabilities	1,428,398	2,571	0.72 %	1,417,614	2,671	0.76 %	1,335,512	2,956	0.89 %
Non-interest-bearing deposits	405,282			385,471			326,020		
Other liabilities	21,103			20,876			23,568		
Total liabilities	1,854,783			1,823,961			1,685,100		
Total stockholders' equity	236,168			226,641			225,888		
Total liabilities and stockholders' equity	$2,090,951			$2,050,602			$1,910,988		
Interest rate spread		$16,377	3.20 %		$15,786	3.17 %		$13,454	2.93 %
Net interest margin			3.39 %			3.35 %			3.13 %

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	For the Six Months Ended June 30, 2014			For the Six Months Ended June 30, 2013		
(Dollars in thousands)	Average Balance	Income/ Expense	Yield/Cost	Average Balance	Income/ Expense	Yield/Cost
Short-term investments	$7,067	$(24)	(0.68)%	$25,172	$44	0.35 %
Other long-term investments	2,211	4	0.36 %	—	—	— %
Investment Securities (1):						
Taxable	616,796	8,569	2.78 %	657,482	8,463	2.57 %
Nontaxable (2)	55,199	1,326	4.80 %	49,602	1,189	4.79 %
Total investment securities	671,995	9,895	2.94 %	707,084	9,652	2.73 %
Loans (3):						
Commercial real estate, construction	52,732	1,012	3.82 %	29,074	645	4.41 %
Commercial real estate, other	459,947	10,383	4.49 %	381,202	8,827	4.61 %
Commercial and industrial	238,767	5,261	4.38 %	181,697	3,647	3.99 %
Residential real estate (4)	278,715	6,380	4.58 %	242,741	5,980	4.93 %
Home equity lines of credit	60,190	1,107	3.68 %	50,569	1,009	3.99 %
Consumer	148,372	3,384	4.60 %	112,071	2,963	5.46 %
Total loans	1,238,723	27,527	4.43 %	997,354	23,071	4.63 %
Less: Allowance for loan losses	(17,177)			(18,322)		
Net loans	1,221,546	27,527	4.50 %	979,032	23,071	4.70 %
Total earning assets	1,902,819	37,402	3.92 %	1,711,288	32,767	3.82 %
Intangible assets	77,684			70,538		
Other assets	90,385			130,794		
Total assets	$2,070,888			$1,912,620		
Deposits:						
Savings accounts	$225,709	$61	0.05 %	$194,940	$51	0.05 %
Governmental deposit accounts	154,295	236	0.31 %	146,775	370	0.51 %
Interest-bearing demand accounts	137,890	57	0.08 %	125,474	50	0.08 %
Money market accounts	273,419	218	0.16 %	277,322	189	0.14 %
Brokered deposits	45,143	818	3.65 %	53,037	944	3.59 %
Retail certificates of deposit	358,360	1,644	0.93 %	365,808	2,132	1.18 %
Total interest-bearing deposits	1,194,816	3,034	0.51 %	1,163,356	3,736	0.65 %
Borrowed Funds:						
Short-term FHLB advances	60,017	30	0.10 %	18,823	10	0.11 %
Retail repurchase agreements	47,422	38	0.16 %	32,661	25	0.15 %
Total short-term borrowings	107,439	68	0.13 %	51,484	35	0.14 %
Long-term FHLB advances	62,243	1,045	3.39 %	64,387	1,084	3.40 %
Wholesale repurchase agreements	40,000	729	3.65 %	40,000	729	3.65 %
Other borrowings	18,536	367	3.94 %	23,283	461	3.94 %
Total long-term borrowings	120,779	2,141	3.56 %	127,670	2,274	3.57 %
Total borrowed funds	228,218	2,209	1.94 %	179,154	2,309	2.58 %
Total interest-bearing liabilities	1,423,034	5,243	0.74 %	1,342,510	6,045	0.91 %
Non-interest-bearing deposits	395,431			323,024		
Other liabilities	20,992			23,252		
Total liabilities	1,839,457			1,688,786		
Total stockholders' equity	231,431			223,834		
Total liabilities and stockholders' equity	$2,070,888			$1,912,620		
Interest rate spread		$32,159	3.18 %		$26,722	2.91 %

Net interest margin	3.37	%	3.11	%

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(1) Average balances are based on carrying value.
(2) Interest income and yields are presented on a fully tax-equivalent basis using a 35% federal statutory tax rate.
(3) Average balances include nonaccrual and impaired loans. Interest income includes interest earned on nonaccrual loans prior to the loans being placed on nonaccrual status. Loan fees included in interest income were immaterial for all periods presented.
(4) Loans held for sale are included in the average loan balance listed. Related interest income on loans originated for sale prior to the loan being sold is included in loan interest income.

Net interest margin, which is calculated by dividing fully tax-equivalent ("FTE") net interest income by average interest-earning assets, serves as an important measurement of the net revenue stream generated by the volume, mix and pricing of earning assets and interest-bearing liabilities. FTE net interest income is calculated by increasing interest income to convert tax-exempt income earned on obligations of states and political subdivisions to the pre-tax equivalent of taxable income using a 35% federal statutory tax rate. The following table details the calculation of FTE net interest income:

	Three Months Ended			Six Months Ended	
(Dollars in thousands)	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	2013
Net interest income, as reported	$16,045	$15,480	$13,155	$31,525	$26,130
Taxable equivalent adjustments	332	306	299	634	592
Fully tax-equivalent net interest income	$16,377	$15,786	$13,454	$32,159	$26,722

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The following table provides an analysis of the changes in FTE net interest income:

(Dollars in thousands)	Three Months Ended June 30, 2014 Compared to March 31, 2014			Three Months Ended June 30, 2014 Compared to June 30, 2013			Six Months Ended June 30, 2014 Compared to June 30, 2013		
Increase (decrease) in:	Rate	Volume	Total [1]	Rate	Volume	Total [1]	Rate	Volume	Total [1]
INTEREST INCOME:									
Short-term investments	$(64)	$—	$(64)	$(63)	$(6)	$(69)	$(55)	$(13)	$(68)
Other long-term investments	(1)	—	(1)	—	2	2	—	4	4
Investment Securities: [2]									
Taxable	(106)	(92)	(198)	1,214	(1,231)	(17)	1,236	(1,130)	106
Nontaxable	(171)	217	46	(54)	134	80	3	134	137
Total investment income	(277)	125	(152)	1,160	(1,097)	63	1,239	(996)	243
Loans:									
Commercial real estate, construction	(33)	49	16	(267)	474	207	(245)	612	367
Commercial real estate, other	(179)	334	155	(793)	1,602	809	(618)	2,174	1,556
Commercial and industrial	63	58	121	217	618	835	382	1,232	1,614
Residential real estate	60	182	242	(399)	792	393	(1,017)	1,417	400
Home equity lines of credit	14	3	17	(181)	236	55	(195)	293	98
Consumer	(298)	455	157	(1,185)	1,428	243	(1,155)	1,576	421
Total loan income	(373)	1,081	708	(2,608)	5,150	2,542	(2,848)	7,304	4,456
Total interest income	(715)	1,206	491	(1,511)	4,049	2,538	(1,664)	6,299	4,635
INTEREST EXPENSE:									
Deposits:									
Savings accounts	(3)	4	1	(1)	5	4	2	8	10
Government deposit accounts	(54)	44	(10)	(133)	78	(55)	(186)	52	(134)
Interest-bearing demand accounts	—	1	1	1	3	4	2	5	7
Money market accounts	(1)	(3)	(4)	13	1	14	36	(7)	29
Brokered certificates of deposit	(18)	(36)	(54)	(6)	(80)	(86)	47	(173)	(126)
Retail certificates of deposit	(29)	(8)	(37)	(331)	117	(214)	(445)	(43)	(488)
Total deposit cost	(105)	2	(103)	(457)	124	(333)	(544)	(158)	(702)
Borrowed funds:									
Short-term borrowings	1	5	6	—	15	15	(1)	34	33
Long-term borrowings	11	(14)	(3)	1	(68)	(67)	(3)	(130)	(133)
Total borrowed funds cost	12	(9)	3	1	(53)	(52)	(4)	(96)	(100)
Total interest expense	(93)	(7)	(100)	(456)	71	(385)	(548)	(254)	(802)
Net interest income	$(622)	$1,213	$591	$(1,055)	$3,978	$2,923	$(1,116)	$6,553	$5,437

(1) The change in interest due to both rate and volume has been allocated to rate and volume changes in proportion to the relationship of the dollar amounts of the changes in each.

(2) Presented on a fully tax-equivalent basis.

Net interest income for the second quarter of 2014 increased 4% compared to the linked quarter and 22% from the prior year second quarter. During the second quarter of 2014, net interest income and margin benefited from accretion income related to the Midwest and Ohio Commerce acquisitions of $50,000 and $226,000, respectively, and when combined, added 6 basis points to net interest margin. In comparison, accretion income from Ohio Commerce was $231,000 in the first quarter of 2014.

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Net interest income continues to grow as increases in average loan balances from higher sales production and acquisitions occur. Loan growth, further reductions in the relative size of the investment portfolio and decreases in funding costs are improving net interest income and margin.

Average loan balances have benefited from double-digit annualized organic loan growth in each of the last five quarters. The organic growth and acquired loans position Peoples to meet, if not surpass, its goal of 15% to 20% year-over-year increase in average loan balances for the full year of 2014.

Peoples' strategy of replacing higher-cost funding with low-cost deposits caused a decline in funding costs in the second quarter of 2014. Compared to the prior year second quarter, loan growth has been funded by increases in low-cost deposits and wholesale funding, in addition to cash flows provided by the investment portfolio.

Management has not changed its overall balance sheet strategies of reducing the size of the investment portfolio relative to total earning assets and minimizing Peoples' long-term interest rate risk by potentially match funding some of the 2014 loan growth. Peoples continues to focus on reducing high-cost funding with increases in low-cost core deposits.

The pending acquisitions could provide management with additional opportunities to make meaningful progress with these balance sheet strategies. Specifically, Peoples could elect to sell some, or all, of the investment securities currently held by the acquired banks and use the proceeds to repay wholesale borrowings. Such action, if taken, would result in a smaller increase in total earning assets and net interest income.

Additional information regarding changes in the Unaudited Consolidated Balance Sheets can be found under appropriate captions of the "FINANCIAL CONDITION" section of this discussion. Additional information regarding Peoples' interest rate risk and the potential impact of interest rate changes on Peoples' results of operations and financial condition can be found later in this discussion under the caption "Interest Rate Sensitivity and Liquidity".

Provision for (Recovery of) Loan Losses

The following table details Peoples' provision for, or recovery of, loan losses:

	Three Months Ended			Six Months Ended	
	June 30,	March 31,	June 30,	June 30,	
(Dollars in thousands)	2014	2014	2013	2014	2013
Provision for checking account overdrafts	$83	$8	$138	$91	$123
Provision for (recovery of) other loan losses	500	—	(1,600)	500	(2,650)
Net provision for (recovery of) loan losses	$583	$8	$(1,462)	$591	$(2,527)
As a percentage of average gross loans (a)	0.19%	—	(0.58)%	0.10%	(0.51)%

(a) Presented on an annualized basis

The provision for, or recovery of, loan losses recorded represents the amount needed to maintain the adequacy of the allowance for loan losses based on management's quarterly analysis of the loan portfolio and procedural methodology that estimates the amount of probable credit losses. This process considers various factors that affect losses, such as changes in Peoples' loan quality, historical loss experience and current economic conditions. The provision for loan losses recorded during the second quarter of 2014 was driven mostly by higher loan growth. During 2014, charge-offs on loans exceeded recoveries by $69,000 for the second quarter and $272,000 on a year-to-date basis. In 2013, recoveries on loans surpassed charge-offs by $1.1 million in the second quarter and $1.8 million year-to-date. Peoples continued to experience loss trends and levels of criticized loans that were below historical averages.

Additional information regarding changes in the allowance for loan losses and loan credit quality can be found later in this discussion under the caption "Allowance for Loan Losses".

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Net Other (Losses) Gains

The following table details the other losses and gains recognized by Peoples:

	Three Months Ended			Six Months Ended	
(Dollars in thousands)	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	2013
Net gain on OREO	$—	$18	$81	$18	$76
Net loss on bank premises and equipment	(187)	(7)	(87)	(194)	(87)
Net other (losses) gains	$(187)	$11	$(6)	$(176)	$(11)

The loss on bank premises and equipment recorded during the second quarter of 2014 included $149,000 of losses due to asset write-offs associated with the Midwest acquisition. The remaining $38,000 of losses were the result of relocation of banking and insurance offices during the second quarter of 2014. The net gain on OREO for the second quarter of 2013 was the result of the sale of two commercial properties. The net loss on bank premises and equipment for the second quarter of 2013 was due to the write-downs of $89,000 related to closed office locations that are available for sale.

Non-Interest Income

Insurance income comprised the largest portion of second quarter 2014 non-interest income. The following table details Peoples' insurance income:

	Three Months Ended			Six Months Ended	
(Dollars in thousands)	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	2013
Property and casualty insurance commissions	$2,709	$2,453	$2,705	$5,162	$4,876
Performance-based commissions	249	1,183	81	1,432	585
Life and health insurance commissions	393	425	309	818	455
Credit life and A&H insurance commissions	9	7	34	16	57
Other fees and charges	83	48	91	131	125
Total insurance income	$3,443	$4,116	$3,220	$7,559	$6,098

The growth in property and casualty insurance commissions was primarily driven by higher premiums throughout the industry and increased production from referrals between lines of business at Peoples. The increase in life and health insurance commissions compared to 2013 was the result of acquisitions completed during the second quarter of 2013. The bulk of performance-based commissions typically are recorded annually in the first quarter and are based on a combination of factors, such as loss experience of insurance policies sold, production volumes, and overall financial performance of the individual insurance carriers.

Deposit account service charges continued to comprise a sizable portion of Peoples' non-interest income. The following table details Peoples' deposit account service charges:

	Three Months Ended			Six Months Ended	
(Dollars in thousands)	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	2013
Overdraft and non-sufficient funds fees	$1,772	$1,544	$1,732	$3,316	$3,337
Account maintenance fees	413	377	311	790	601
Other fees and charges	42	190	2	232	164
Total deposit account service charges	$2,227	$2,111	$2,045	$4,338	$4,102

The amount of deposit account service charges, particularly fees for overdrafts and non-sufficient funds, is largely dependent on the timing and volume of customer activity. Peoples typically experiences a lower volume of overdraft and non-sufficient funds fees annually in the first quarter attributable to customers receiving income tax refunds, while volumes generally increase in the fourth quarter in connection with the holiday shopping season.

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Peoples' fiduciary and brokerage revenues continue to be based primarily upon the value of assets under management, with additional income generated from transaction commissions. The following tables detail Peoples' trust and investment income and related assets under management:

	Three Months Ended			Six Months Ended	
(Dollars in thousands)	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	2013
Fiduciary	$1,434	$1,329	$1,293	$2,763	$2,482
Brokerage	499	518	479	1,017	992
Total trust and investment income	$1,933	$1,847	$1,772	$3,780	$3,474

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Trust assets under management	$1,014,865	$995,861	$1,000,171	$994,683	$939,292
Brokerage assets under management	513,890	494,246	474,384	449,196	433,651
Total managed assets	$1,528,755	$1,490,107	$1,474,555	$1,443,879	$1,372,943
Quarterly average	$1,505,433	$1,479,110	$1,455,429	$1,417,707	$1,373,135

Over the last several years, Peoples has continued to attract new managed funds, due in part to the addition of experienced financial advisors in previously underserved market areas. In addition, Peoples added new business related to the retirement plans for which it manages the assets and provides services. The U.S. financial markets have experienced a general increase in market value since the beginning of 2013, which have also contributed to the increase in managed assets.

Peoples electronic banking services include ATM and debit cards, direct deposit services, internet banking, and personal electronic device applications, and serve as alternative delivery channels to traditional sales offices for providing services to customers. The growth in electronic banking income during the first half of 2014 was primarily due to an increase in the volume of debit card transactions.

Mortgage banking income decreased significantly from 2013 due to reduced refinancing activity, which is driven by mortgage interest rates available in the secondary market and customers' preference for long-term, fixed-rate loans. Compared to the linked quarter, mortgage banking income was up slightly due to the seasonality in the industry as home purchases typically increase during the spring and early summer. In the second quarter of 2014, Peoples sold approximately $11.3 million of loans to the secondary market compared to $7.8 million in the first quarter of 2014 and $14 million in the second quarter of 2013. In the first six months of 2014, Peoples sold approximately $19.1 million compared to $46.1 million in the first half of 2013.

Non-Interest Expense

Salaries and employee benefit costs remain Peoples' largest non-interest expense, accounting for more than half of total non-interest expense.

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The following table details Peoples' salaries and employee benefit costs:

	Three Months Ended			Six Months Ended	
(Dollars in thousands)	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	2013
Base salaries and wages	$7,037	$6,513	$5,866	$13,550	$11,498
Sales-based and incentive compensation	1,587	1,503	1,874	3,090	3,399
Employee benefits	1,791	1,760	771	3,551	1,753
Stock-based compensation	464	490	386	954	683
Deferred personnel costs	(353)	(366)	(589)	(719)	(1,083)
Payroll taxes and other employment costs	715	892	626	1,607	1,401
Total salaries and employee benefit costs	$11,241	$10,792	$8,934	$22,033	$17,651
Full-time equivalent employees:					
Actual at end of period	576	557	545	576	545
Average during the period	563	549	531	556	521

For the three months ended June 30, 2014, base salaries and wages were primarily higher than the linked quarter as a result of severance and retention payouts associated with the Midwest acquisition. Compared to the prior year second quarter, the increase was due to the addition of new sales talent in several markets and completed acquisitions that have increased the number of full-time equivalent employees. Employee medical benefit costs were essentially flat compared to the prior quarter and nearly doubled compared to prior year second quarter due to higher claim activity experienced. During the second quarter of 2014, Peoples recorded a one-time pension settlement charge of $536,000, compared to $486,000 in the first quarter of 2014 and for which no charges were recorded in the first half of 2013. Given the nature of the pension settlement, it is inherently difficult to estimate the amount or exact timing of future pension settlement charges.

Peoples' net occupancy and equipment expense was comprised of the following:

	Three Months Ended			Six Months Ended	
(Dollars in thousands)	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	2013
Depreciation	$677	$685	$590	$1,362	$1,357
Repairs and maintenance costs	451	458	460	909	907
Net rent expense	219	241	200	461	421
Property taxes, utilities and other costs	392	432	376	823	799
Total net occupancy and equipment expense	$1,739	$1,816	$1,626	$3,555	$3,484

Net occupancy and equipment expense was stable in the second quarter and first six months of 2014 compared to prior periods. Seasonal fluctuations occur in the timing of repairs and maintenance costs, such as snow removal, and are generally higher in the first and fourth quarters.

Professional fees increased during the second quarter of 2014 due to $375,000 of additional expenses associated with acquisition activity, compared to $91,000 in the linked quarter and $37,000 in the prior year. Through the first six months of 2014, professional fees increased $278,000, which was primarily caused by acquisition-related expenses.

Electronic banking expense, which is comprised of bankcard and internet-based banking costs, continued to increase in the second quarter and first six months of 2014 compared to prior periods. The primary reasons for the increase were a higher volume of transactions completed by customers and additional services provided.

Peoples' efficiency ratio, calculated as non-interest expense less amortization of other intangible assets divided by FTE net interest income plus non-interest income, was 75.58% for the second quarter of 2014, higher than the linked quarter of 71.13% and the prior year second quarter of 71.71%. Management continues to target an efficiency ratio in the range of 68% to 70%, absent acquisition-related costs and other one-time expenses, such as pension settlement charges.

Income Tax Expense

For the six months ended June 30, 2014, Peoples recorded income tax expense of $3.7 million, for an effective tax rate of 31.1%. This effective tax rate represents management's current estimate of the rate for the entire year. In comparison, Peoples recorded income tax expense of $4.8 million for the same period in 2013, for an effective tax rate of 32.7%.

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Pre-Provision Net Revenue

Pre-provision net revenue ("PPNR") has become a key financial measure used by federal bank regulatory agencies when assessing the capital adequacy of financial institutions. PPNR is defined as net interest income plus non-interest income minus non-interest expense and, therefore, excludes the provision for loan losses and all gains and losses included in earnings. As a result, PPNR represents the earnings capacity that can be either retained in order to build capital or used to absorb unexpected losses and preserve existing capital.

The following table provides a reconciliation of this non-GAAP financial measure to the amounts reported in Peoples' consolidated financial statements for the periods presented:

	Three Months Ended			Six Months Ended	
(Dollars in thousands)	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	2013
Pre-Provision Net Revenue:					
Income before income taxes	$5,057	$6,931	$7,431	$11,988	$14,771
Add: provision for loan losses	583	8	—	591	—
Add: loss on debt extinguishment	—	—	—	—	—
Add: net loss on loans held-for-sale and OREO	—	—	—	—	—
Add: net loss on securities transactions	—	30	—	30	—
Add: net loss on other assets	187	7	87	194	87
Less: recovery of loan losses	—	—	1,462	—	2,527
Less: net gain on loans held-for-sale and OREO	—	18	81	18	76
Less: net gain on securities transactions	66	—	26	66	444
Pre-provision net revenue	$5,761	$6,958	$5,949	$12,719	$11,811
Pre-provision net revenue	$5,761	$6,958	$5,949	$12,719	$11,811
Total average assets	2,090,951	2,050,602	1,910,988	2,070,888	1,912,620
Pre-provision net revenue to total average assets (a)	1.11 %	1.38 %	1.25 %	1.24 %	1.25 %

(a) Presented on an annualized basis.

During the second quarter of 2014, PPNR decreased due to additional costs from acquisition-related activities.

FINANCIAL CONDITION

Cash and Cash Equivalents

At June 30, 2014, Peoples' interest-bearing deposits in other banks decreased compared to December 31, 2013. These balances included $2.0 million of excess cash reserves being maintained at the Federal Reserve Bank at June 30, 2014, compared to $14.2 million at December 31, 2013. The amount of excess cash reserves maintained is dependent upon Peoples' daily liquidity position, which is driven primarily by changes in deposit and loan balances.

Through six months of 2014, Peoples' total cash and cash equivalents increased $0.1 million, as cash provided by operating activities totaling $14.4 million was mostly offset by cash used in investing and financing activities. Within Peoples' investing activities, the $50.1 million generated by activities related to available-for-sale securities, and $6.3 million in proceeds from bank owned life insurance contracts were used to partially fund the $62.8 million net loan growth. Peoples' financing activities used $1.9 million as payments on long-term borrowings and cash dividends paid to shareholders exceeded cash provided by deposits and short-term borrowings.

In comparison, through the six months of 2013, Peoples' total cash and cash equivalents decreased $24.8 million, as cash used in Peoples' investing and financing activities exceeded the $20.3 million of cash generated by operating activities. Investing activities used $27.6 million of cash to partially fund the $42.9 million net loan growth, while proceeds from sales and principal payments of investment securities exceeded purchases by $12.8 million. Within Peoples' financing activities, the decrease in deposits of $56.5 million resulted in increased borrowed funds of $41.6

million.

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Further information regarding the management of Peoples' liquidity position can be found later in this discussion under “Interest Rate Sensitivity and Liquidity.”

Investment Securities

The following table provides information regarding Peoples’ investment portfolio:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Available-for-sale securities, at fair value:					
Obligations of:					
U.S. Treasury and government agencies	$19	$19	$20	$22	$23
U.S. government sponsored agencies	—	295	319	356	400
States and political subdivisions	61,281	51,668	50,962	51,061	50,579
Residential mortgage-backed securities	491,628	500,516	510,097	519,387	503,574
Commercial mortgage-backed securities	27,746	26,750	32,304	33,135	33,606
Bank-issued trust preferred securities	8,132	7,995	7,829	7,868	7,811
Equity securities	4,997	4,854	4,577	4,207	4,335
Total fair value	$593,803	$592,097	$606,108	$616,036	$600,328
Total amortized cost	$592,954	$598,445	$621,126	$623,024	$606,441
Net unrealized gain (loss)	$849	$(6,348)	$(15,018)	$(6,988)	$(6,113)
Held-to-maturity securities, at amortized cost:					
Obligations of:					
States and political subdivisions	$3,845	$3,848	$3,850	$3,853	$3,855
Residential mortgage-backed securities	37,766	37,151	37,536	38,046	36,361
Commercial mortgage-backed securities	7,765	7,804	7,836	7,859	7,882
Total amortized cost	$49,376	$48,803	$49,222	$49,758	$48,098
Total investment portfolio:					
Amortized cost	$642,330	$647,248	$670,348	$672,782	$654,539
Carrying value	$643,179	$640,900	$655,330	$665,794	$648,426

In the second quarter of 2014, reductions in the investment portfolio from the linked quarter were partially offset by increases in the unrealized gain or loss position of the securities. Peoples continues to use principal paydowns on securities to fund loan growth, in an effort to reduce the size of the investment portfolio. At June 30, 2014, the investment portfolio was 31% of total assets compared to 33% at year-end and 35% a year ago. In recent quarters, Peoples has maintained the size of the held-to-maturity securities portfolio, for which the unrealized gain or loss does not directly impact stockholders' equity, contrary to the available-for-sale securities portfolio.

Peoples' investment in residential and commercial mortgage-backed securities largely consists of securities either guaranteed by the U.S. government or issued by U.S. government sponsored agencies, such as Fannie Mae and Freddie Mac. The remaining portions of Peoples' mortgage-backed securities consist of securities issued by other entities, including other financial institutions, which are not guaranteed by the U.S. government.

The amount of these “non-agency” securities included in the residential mortgage-backed securities totals above was as follows:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Total fair value	$16,864	$21,351	$23,446	$25,573	$30,065
Total amortized cost	$16,268	$20,562	$22,926	$24,430	$28,820
Net unrealized gain	$596	$789	$520	$1,143	$1,245

Management continues to reinvest the principal runoff from the non-agency securities into U.S agency investments, which has accounted for the continued decline in the fair value of these securities. At June 30, 2014, Peoples'

non-agency portfolio consisted entirely of first lien residential mortgages, with nearly all of the underlying loans in these securities

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originated prior to 2004 and possessing fixed interest rates. Management continues to monitor the non-agency portfolio closely for leading indicators of increasing stress and will continue to be proactive in taking actions to mitigate such risk when necessary.

Loans

The following table provides information regarding outstanding loan balances:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Gross portfolio loans:					
Commercial real estate, construction	$56,421	$55,935	$47,539	$39,969	$30,770
Commercial real estate, other	463,734	458,580	450,170	374,953	389,281
Commercial real estate	520,155	514,515	497,709	414,922	420,051
Commercial and industrial	254,561	233,329	232,754	192,238	184,981
Residential real estate	314,190	268,794	268,617	262,602	252,282
Home equity lines of credit	61,838	60,319	60,076	55,341	52,212
Consumer	163,326	143,541	135,018	127,785	119,029
Deposit account overdrafts	5,282	6,008	2,060	4,277	1,674
Total portfolio loans	$1,319,352	$1,226,506	$1,196,234	$1,057,165	$1,030,229
Percent of loans to total loans:					
Commercial real estate, construction	4.3 %	4.6 %	4.0 %	3.8 %	3.0 %
Commercial real estate, other	35.1 %	37.4 %	37.6 %	35.5 %	37.8 %
Commercial real estate	39.4 %	42.0 %	41.6 %	39.3 %	40.8 %
Commercial and industrial	19.3 %	19.0 %	19.5 %	18.2 %	17.9 %
Residential real estate	23.8 %	21.9 %	22.5 %	24.8 %	24.5 %
Home equity lines of credit	4.7 %	4.9 %	5.0 %	5.2 %	5.1 %
Consumer	12.4 %	11.7 %	11.3 %	12.1 %	11.5 %
Deposit account overdrafts	0.4 %	0.5 %	0.1 %	0.4 %	0.2 %
Total percentage	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %
Residential real estate loans being serviced for others	$341,893	$340,057	$341,183	$339,557	$338,854

Gross portfolio loans increased $92.8 million, or 8% from the prior quarter due to organic growth and the Midwest acquisition. The loans acquired from Midwest added approximately $2.1 million of commercial real estate loans, $3.2 million of commercial and industrial loans, $47.1 million of residential real estate loans and $7.3 million of consumer loans after purchase accounting adjustments. The remaining increase in commercial and industrial loans was primarily driven by several new loan originations during the second quarter of 2014. Consumer loan balances, which consist mostly of loans to finance automobile purchases, have continued to increase in recent quarters due largely to Peoples placing greater emphasis on its consumer lending activity.

Loan Concentration

Peoples categorizes its commercial loans according to standard industry classifications and monitors for concentrations in a single industry or multiple industries that could be impacted by changes in economic conditions in a similar manner. Peoples' commercial lending activities continue to be spread over a diverse range of businesses from all sectors of the economy, with no single industry comprising over 10% of Peoples' total loan portfolio.

Loans secured by commercial real estate, including commercial construction loans, continue to comprise the largest portion of Peoples' loan portfolio.

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The following table provides information regarding the largest concentrations of commercial real estate loans within the loan portfolio at June 30, 2014:

(Dollars in thousands)	Outstanding Balance	Loan Commitments	Total Exposure	% of Total	
Commercial real estate, other:					
Lodging and lodging related	$53,196	$—	$53,196	11.3	%
Apartment complexes	65,084	206	65,290	13.9	%
Office buildings and complexes:					
Owner occupied	16,443	364	16,807	3.6	%
Non-owner occupied	28,745	112	28,857	6.1	%
Total office buildings and complexes	45,188	476	45,664	9.7	%
Light industrial facilities:					
Owner occupied	30,519	406	30,925	6.6	%
Non-owner occupied	2,112	—	2,112	0.4	%
Total light industrial facilities	32,631	406	33,037	7.0	%
Retail facilities:					
Owner occupied	15,598	129	15,727	3.3	%
Non-owner occupied	30,929	—	30,929	6.6	%
Total retail facilities	46,527	129	46,656	9.9	%
Assisted living facilities and nursing homes	45,905	251	46,156	9.8	%
Mixed commercial use facilities:					
Owner occupied	21,814	1,100	22,914	4.9	%
Non-owner occupied	19,060	337	19,397	4.1	%
Total mixed commercial use facilities	40,874	1,437	42,311	9.0	%
Day care facilities - owner occupied	15,971	—	15,971	3.4	%
Health care facilities:					
Owner occupied	5,884	11	5,895	1.3	%
Non-owner occupied	15,828	300	16,128	3.4	%
Total health care facilities	21,712	311	22,023	4.7	%
Restaurant facilities:					
Owner occupied	12,048	50	12,098	2.6	%
Non-owner occupied	1,116	—	1,116	0.2	%
Total restaurant facilities	13,164	50	13,214	2.8	%
Other	83,482	3,347	86,829	18.5	%
Total commercial real estate, other	$463,734	$6,613	$470,347	100.0	%
Commercial real estate, construction:					
Apartment complexes	$31,671	$8,721	$40,392	48.9	%
Office buildings and complexes:					
Owner occupied	1,554	247	1,801	2.2	%
Non-owner occupied	3	4,800	4,803	5.8	%
Total office buildings and complexes	1,557	5,047	6,604	8.0	%
Light industrial facilities:					
Owner occupied	825	—	825	1.0	%
Non-owner occupied	210	—	210	0.3	%
Total light industrial facilities	1,035	—	1,035	1.3	%
Assisted living facilities and nursing homes	6,422	3,530	9,952	12.0	%
Mixed commercial use facilities	2,212	1,521	3,733	4.5	%
Day care facilities - owner occupied	2,191	302	2,493	3.0	%
Restaurant facilities - owner occupied	3,540	—	3,540	4.3	%

Residential property	3,188	4,061	7,249	8.8	%
Other	4,605	3,024	7,629	9.2	%
Total commercial real estate, construction	$56,421	$26,206	$82,627	100.0	%

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Peoples' commercial lending activities continue to focus on lending opportunities inside its primary and secondary market areas within Ohio, West Virginia and Kentucky. In all other states, the aggregate outstanding balances of commercial loans in each state were less than $4.0 million at both June 30, 2014 and December 31, 2013.

Allowance for Loan Losses

The amount of the allowance for loan losses at the end of each period represents management's estimate of expected losses from existing loans based upon its quarterly analysis of the loan portfolio. While this process involves allocations being made to specific loans and pools of loans, the entire allowance is available for all losses incurred within the loan portfolio. The following details management's allocation of the allowance for loan losses:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Commercial real estate	10,267	13,327	13,215	12,826	12,568
Commercial and industrial	3,219	2,130	2,174	2,195	2,188
Total commercial	13,486	15,457	15,389	15,021	14,756
Residential real estate	1,818	782	881	826	1,005
Home equity lines of credit	656	329	343	337	490
Consumer	1,298	198	316	564	740
Deposit account overdrafts	126	104	136	154	122
Total allowance for loan losses	$17,384	$16,870	$17,065	$16,902	$17,113
As a percent of loans, net of deferred fees and costs	1.32%	1.38%	1.43%	1.60%	1.66%

The significant allocations to commercial loans reflect the higher credit risk associated with this type of lending and the size of this loan category in relationship to the entire loan portfolio. In the second quarter of 2014, Peoples increased the allowance for loan losses due to loan growth during recent quarters. Peoples' asset quality continued to remain favorable during 2014. Net charge-offs also remained at or below Peoples' long-term historical rate. These factors had a direct impact on the estimated loss rates used to determine the appropriate allocations for commercial loans.

The allowance allocated to the residential real estate and consumer loan categories is based upon Peoples' allowance methodology for homogeneous pools of loans. The fluctuations in these allocations have been directionally consistent with the changes in loan quality, loss experience and loan balances in these categories.

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The following table summarizes Peoples' net charge-offs and recoveries:

(Dollars in thousands)	Three Months Ended June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Gross charge-offs:					
Commercial real estate, construction	$—	$—	$—	$—	$—
Commercial real estate, other	—	—	71	199	217
Commercial real estate	—	—	71	199	217
Commercial and industrial	—	49	33	—	11
Residential real estate	135	137	181	218	88
Home equity lines of credit	25	20	—	160	—
Consumer	250	302	439	301	185
Deposit account overdrafts	91	110	147	135	115
Total gross charge-offs	501	618	871	1,013	616
Recoveries:					
Commercial real estate, construction	—	—	—	—	—
Commercial real estate, other	96	112	1,526	1,507	1,432
Commercial real estate	96	112	1,526	1,507	1,432
Commercial and industrial	54	5	12	7	4
Residential real estate	79	38	236	39	145
Home equity lines of credit	6	6	6	7	5
Consumer	167	184	191	125	132
Deposit account overdrafts	30	70	27	36	34
Total recoveries	432	415	1,998	1,721	1,752
Net charge-offs (recoveries):					
Commercial real estate, construction	—	—	—	—	—
Commercial real estate, other	(96)	(112)	(1,455)	(1,308)	(1,215)
Commercial real estate	(96)	(112)	(1,455)	(1,308)	(1,215)
Commercial and industrial	(54)	44	21	(7)	7
Residential real estate	56	99	(55)	179	(57)
Home equity lines of credit	19	14	(6)	153	(5)
Consumer	83	118	248	176	53
Deposit account overdrafts	61	40	120	99	81
Total net charge-offs (recoveries)	$69	$203	$(1,127)	$(708)	$(1,136)
Ratio of net charge-offs (recoveries) to average loans (annualized):					
Commercial real estate, construction	—%	—%	—%	—%	—%
Commercial real estate, other	(0.03)%	(0.04)%	(0.51)%	(0.50)%	(0.48)%
Commercial real estate	(0.03)%	(0.04)%	(0.51)%	(0.50)%	(0.48)%
Commercial and industrial	(0.03)%	0.02%	0.01%	—%	—%
Residential real estate	0.02%	0.03%	(0.02)%	0.07%	(0.02)%
Home equity lines of credit	0.01%	0.01%	—%	0.06%	—%
Consumer	0.03%	0.04%	0.09%	0.07%	0.03%
Deposit account overdrafts	0.02%	0.01%	0.04%	0.04%	0.02%
Total	0.02%	0.07%	(0.39)%	(0.26)%	(0.45)%

Throughout the first half of 2014, net charge-offs remained well below the long-term historical average of 0.30% to 0.50%.

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The following table details Peoples' nonperforming assets:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Loans 90+ days past due and accruing:					
Commercial real estate, other	$1,138	$—	$—	$—	$36
Commercial and industrial	903	—	—	950	—
Residential real estate	1,290	29	37	—	—
Home equity	39	129	873	1,615	1,484
Consumer	20	1	—	32	—
Total	3,390	159	910	2,597	1,520
Nonaccrual loans:					
Commercial real estate, construction	—	96	96	76	80
Commercial real estate, other	1,834	2,913	2,801	3,593	4,922
Commercial and industrial	806	640	708	323	297
Residential real estate	2,945	3,294	2,565	3,012	3,136
Home equity	256	323	81	61	32
Consumer	—	—	58	60	62
Total	5,841	7,266	6,309	7,125	8,529
Troubled debt restructurings:					
Commercial real estate, construction	96	897	916	1,193	1,879
Commercial real estate, other	1,356	—	—	—	—
Commercial and industrial	—	—	—	—	—
Residential real estate	675	637	650	195	175
Home equity	36	6	6	24	24
Total	2,163	1,540	1,572	1,412	2,078
Total nonperforming loans (NPLs)	11,394	8,965	8,791	11,134	12,127
Other real estate owned (OREO)					
Commercial	465	465	465	—	—
Residential	450	308	428	120	120
Total	915	773	893	120	120
Total nonperforming assets (NPAs)	$12,309	$9,738	$9,684	$11,254	$12,247
NPLs as a percent of total loans	0.86 %	0.73 %	0.73 %	1.05 %	1.17 %
NPAs as a percent of total assets	0.57 %	0.47 %	0.47 %	0.59 %	0.64 %
NPAs as a percent of total loans and OREO	0.93 %	0.79 %	0.81 %	1.06 %	1.18 %
Allowance for loan losses as a percent of NPLs	152.57 %	188.19 %	194.13 %	151.79 %	141.11 %

During the second quarter of 2014, loans reported as accruing and 90 days past due increased significantly, primarily due to a single relationship of $1.2 million that is expected to payoff during the third quarter of 2014, coupled with acquired balances from the Midwest acquisition. The increase in OREO during the second quarter of 2014 was also the result of properties acquired from the Midwest acquisition.

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Deposits

The following table details Peoples' deposit balances:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Interest-bearing deposits:					
Retail certificates of deposit	$373,072	$355,345	$363,226	$334,910	$349,511
Money market deposit accounts	268,939	276,226	275,801	224,400	238,554
Governmental deposit accounts	165,231	177,590	132,379	151,910	146,817
Savings accounts	244,472	227,695	215,802	196,293	199,503
Interest-bearing demand accounts	142,170	133,508	134,618	123,966	125,875
Total retail interest-bearing deposits	1,193,884	1,170,364	1,121,826	1,031,479	1,060,260
Brokered certificates of deposits	40,650	45,072	49,041	49,620	50,393
Total interest-bearing deposits	1,234,534	1,215,436	1,170,867	1,081,099	1,110,653
Non-interest-bearing deposits	426,384	417,629	409,891	356,767	325,125
Total deposits	$1,660,918	$1,633,065	$1,580,758	$1,437,866	$1,435,778

During the second quarter of 2014, Peoples completed the acquisition of Midwest, which included retail certificates of deposits ("CDs") totaling $36.2 million, money market deposit accounts of $3.8 million, governmental deposit accounts of $0.5 million, savings accounts of $15.1 million, interest-bearing demand accounts of $7.1 million and non-interest bearing deposits of $15.4 million. Excluding the acquired deposit accounts, retail certificates of deposit, money market deposit accounts and governmental deposit accounts declined $42.4 million from March 31, 2014. Peoples maintained its deposit strategy of growing low-cost core deposits, such as checking and savings accounts, and reducing its reliance on higher-cost, non-core deposits, such as CDs and brokered deposits.

Borrowed Funds

The following table details Peoples' short-term and long-term borrowings:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Short-term borrowings:					
FHLB advances	$48,000	$15,000	$71,000	$64,000	$59,000
Retail repurchase agreements	67,869	53,777	42,590	42,843	33,521
Total short-term borrowings	115,869	68,777	113,590	106,843	92,521
Long-term borrowings:					
FHLB advances	62,056	62,211	62,679	63,806	64,180
National market repurchase agreements	40,000	40,000	40,000	40,000	40,000
Term note payable (parent company)	16,759	17,953	19,147	20,340	21,534
Total long-term borrowings	118,815	120,164	121,826	124,146	125,714
Total borrowed funds	$234,684	$188,941	$235,416	$230,989	$218,235

Peoples' short-term FHLB advances generally consist of overnight borrowings being maintained in connection with the management of Peoples' daily liquidity position.

As disclosed in Peoples' 2013 Form 10-K, Peoples entered into a loan agreement in 2012, and is subject to certain covenants. At June 30, 2014, Peoples was in compliance with the applicable material covenants imposed by this agreement, as explained in more detail in Note 10 of the Notes to the Consolidated Financial Statements included in Peoples' 2013 Form 10-K.

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Capital/Stockholders' Equity

During the second quarter of 2014, Peoples issued common shares (representing $6.3 million) in partial consideration for the Midwest acquisition, and the remaining consideration was paid in cash. Accumulated other comprehensive income also benefited from an increase in the market value of available-for-sale investment securities. At June 30, 2014, capital levels for both Peoples and Peoples Bank remained substantially higher than the minimum amounts needed to be considered "well capitalized" institutions under banking regulations. These higher capital levels reflect Peoples' desire to maintain strong capital positions to provide greater flexibility to grow the company.

The following table details Peoples' actual risk-based capital levels and corresponding ratios:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Capital Amounts:					
Tier 1	177,394	170,677	166,217	168,254	166,576
Total (Tier 1 and Tier 2)	196,426	189,145	184,457	184,550	182,706
Net risk-weighted assets	$1,438,683	$1,358,691	$1,338,811	$1,194,016	$1,175,647
Capital Ratios:					
Tier 1	12.33 %	12.56 %	12.42 %	14.09 %	14.17 %
Total (Tier 1 and Tier 2)	13.65 %	13.92 %	13.78 %	15.46 %	15.54 %
Leverage ratio	8.76 %	8.56 %	8.52 %	9.14 %	9.04 %

In addition to traditional capital measurements, management uses tangible capital measures to evaluate the adequacy of Peoples' stockholders' equity. Such ratios represent non-GAAP financial information since their calculation removes the impact of intangible assets acquired through acquisitions on the Unaudited Consolidated Balance Sheets. Management believes this information is useful to investors since it facilitates the comparison of Peoples' operating performance, financial condition and trends to peers, especially those without a similar level of intangible assets to that of Peoples. Further, intangible assets generally are difficult to convert into cash, especially during a financial crisis, and could decrease substantially in value should there be deterioration in the overall franchise value. As a result, tangible equity represents a conservative measure of the capacity for a company to incur losses but remain solvent.

The following table reconciles the calculation of these non-GAAP financial measures to amounts reported in Peoples' Unaudited Consolidated Financial Statements:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Tangible Equity:					
Total stockholders' equity, as reported	$244,271	$230,576	$221,553	$222,247	$219,147
Less: goodwill and other intangible assets	79,273	77,288	77,603	71,417	71,608
Tangible equity	$164,998	$153,288	$143,950	$150,830	$147,539
Tangible Assets:					
Total assets, as reported	$2,163,892	$2,078,253	$2,059,108	$1,919,705	$1,899,841
Less: goodwill and other intangible assets	79,273	77,288	77,603	71,417	71,608
Tangible assets	$2,084,619	$2,000,965	$1,981,505	$1,848,288	$1,828,233
Tangible Book Value per Share:					
Tangible equity	$164,998	$153,288	$143,950	$150,830	$147,539
Shares outstanding	10,926,436	10,657,569	10,605,782	10,596,797	10,583,161
Tangible book value per share	$15.10	$14.38	$13.57	$14.23	$13.94

Tangible Equity to Tangible Assets Ratio:						
Tangible equity	$164,998	$153,288	$143,950	$150,830	$147,539	
Tangible assets	$2,084,619	$2,000,965	$1,981,505	$1,848,288	$1,828,233	
Tangible equity to tangible assets	7.92	% 7.66	% 7.26	% 8.16	% 8.07	%

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The increase in the linked quarter tangible equity to tangible assets ratio during the second quarter of 2014 was primarily caused by the issuance of equity in the Midwest acquisition and an increase in the market value of the available-for-sale investment portfolio. Compared to the second quarter of 2013, increases in stockholders' equity were driven primarily by earnings exceeding dividends, while higher tangible assets were attributable to loan production and acquisitions.

Interest Rate Sensitivity and Liquidity

While Peoples is exposed to various business risks, the risks relating to interest rate sensitivity and liquidity are major risks that can materially impact future results of operations and financial condition due to their complexity and dynamic nature. The objective of Peoples' asset/liability management (“ALM”) function is to measure and manage these risks in order to optimize net interest income within the constraints of prudent capital adequacy, liquidity and safety. This objective requires Peoples to focus on interest rate risk exposure and adequate liquidity through its management of the mix of assets and liabilities, their related cash flows, and the rates earned and paid on those assets and liabilities. Ultimately, the ALM function is intended to guide management in the acquisition and disposition of earning assets, and selection of appropriate funding sources.

Interest Rate Risk

Interest rate risk (“IRR”) is one of the most significant risks arising in the normal course of business of financial services companies like Peoples. IRR is the potential for economic loss due to future interest rate changes that can impact the earnings stream as well as market values of financial assets and liabilities. Peoples' exposure to IRR is due primarily to differences in the maturity or repricing of earning assets and interest-bearing liabilities. In addition, other factors, such as prepayments of loans and investment securities or early withdrawal of deposits, can expose Peoples to IRR and increase interest costs or reduce revenue streams.

Peoples has assigned overall management of IRR to its Asset-Liability Committee (the “ALCO”), which has established an IRR management policy that sets minimum requirements and guidelines for monitoring and managing the level and amount of IRR. The methods used by the ALCO to assess IRR remain unchanged from those disclosed in Peoples' 2013 Form 10-K.

The following table shows the estimated changes in net interest income and the economic value of equity based upon a standard, parallel shock analysis (dollars in thousands):

Increase in Interest Rate	Estimated Increase in Net Interest Income						Estimated Decrease in Economic Value of Equity					
(in Basis Points)	June 30, 2014			December 31, 2013			June 30, 2014			December 31, 2013		
300	$6,504	10.1	%	$5,473	8.9	%	$(53,632)	(17.9)	%	$(65,867)	(24.8)	%
200	5,329	8.3	%	4,494	7.3	%	(35,273)	(11.8)	%	(46,077)	(17.4)	%
100	3,411	5.3	%	2,885	4.7	%	(16,404)	(5.5)	%	(23,910)	(9.0)	%

At June 30, 2014, Peoples' Consolidated Balance Sheet remained positioned for a rising interest rate environment, as illustrated by the potential increase in net interest income shown in the above table. The benefit of the actions taken late in the first quarter of 2013 within the investment portfolio to reduce interest rate exposure were fully reflected in the analysis above. While parallel interest rate shock scenarios are useful in assessing the level of IRR inherent in Peoples' Consolidated Balance Sheet, interest rates typically move in a non-parallel manner, with differences in the timing, direction and magnitude of changes in short-term and long-term interest rates. Thus, any benefit that could occur as a result of the Federal Reserve Board increasing short-term interest rates in future quarters could be offset by an inverse movement in long-term interest rates.

Liquidity

In addition to IRR management, another major objective of the ALCO is to maintain a sufficient level of liquidity. The methods used by the ALCO to monitor and evaluate the adequacy of Peoples' liquidity position remain unchanged from those disclosed in Peoples' 2013 Form 10-K.

At June 30, 2014, Peoples had liquid assets of $188.9 million, which represented 8.1% of total assets and unfunded commitments. This amount exceeded the minimal level of $46.5 million, or 2% of total loans and unfunded commitments, currently required under Peoples' liquidity policy. Peoples also had an additional $40.8 million of

unpledged securities not included in the measurement of liquid assets.

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Management believes the current balance of cash and cash equivalents and anticipated cash flows from the investment portfolio, along with the availability of other funding sources, will allow Peoples to meet anticipated cash obligations, as well as special needs and off-balance sheet commitments.

Off-Balance Sheet Activities and Contractual Obligations

Peoples routinely engages in activities that involve, to varying degrees, elements of risk that are not reflected in whole or in part in the Unaudited Consolidated Financial Statements. These activities are part of Peoples' normal course of business and include traditional off-balance sheet credit-related financial instruments, interest rate contracts and commitments to make additional capital contributions in low-income housing tax credit investments. Traditional off-balance sheet credit-related financial instruments continue to represent the most significant off-balance sheet exposure.

The following table details the total contractual amount of loan commitments and standby letters of credit:

(Dollars in thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
Home equity lines of credit	$50,558	$49,918	$49,533	$45,655	$43,956
Unadvanced construction loans	29,396	23,231	30,203	25,923	25,646
Other loan commitments	155,858	136,805	137,661	129,418	138,783
Loan commitments	235,812	209,954	217,397	200,996	208,385
Standby letters of credit	$33,852	$33,555	$33,998	$34,804	$35,845

Management does not anticipate Peoples' current off-balance sheet activities will have a material impact on its future results of operations and financial condition based on historical experience and recent trends.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information called for by this Item 3 is provided under the caption "Interest Rate Sensitivity and Liquidity" under "ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION" in this Form 10-Q, and is incorporated herein by reference.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Peoples' management, with the participation of Peoples' President and Chief Executive Officer and Peoples' Executive Vice President, Chief Financial Officer and Treasurer, has evaluated the effectiveness of Peoples' disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of June 30, 2014. Based upon that evaluation, Peoples' President and Chief Executive Officer and Peoples' Executive Vice President, Chief Financial Officer and Treasurer have concluded that:

(a) information required to be disclosed by Peoples in this Quarterly Report on Form 10-Q and other reports Peoples files or submits under the Exchange Act would be accumulated and communicated to Peoples' management, including its President and Chief Executive Officer and its Executive Vice President, Chief Financial Officer and Treasurer, as appropriate to allow timely decisions regarding required disclosure;

(b) information required to be disclosed by Peoples in this Quarterly Report on Form 10-Q and other reports Peoples files or submits under the Exchange Act would be recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and

(c) Peoples' disclosure controls and procedures were effective as of the end of the fiscal quarter covered by this Quarterly Report on Form 10-Q.

Changes in Internal Control Over Financial Reporting

There were no changes in Peoples' internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during Peoples' fiscal quarter ended June 30, 2014, that have materially affected, or are reasonably likely to materially affect, Peoples' internal control over financial reporting.

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PART II

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of their respective businesses or operations, Peoples or one of its subsidiaries may be named as a plaintiff, a defendant, or a party to a legal proceeding or any of their respective properties may be subject to various pending and threatened legal proceedings and various actual and potential claims. In view of the inherent difficulty of predicting the outcome of such matters, Peoples cannot state what the eventual outcome of any such matters will be; however, based on current knowledge and after consultation with legal counsel, management believes these proceedings will not have a material adverse effect on the consolidated financial position, results of operations or liquidity of Peoples.

ITEM 1A. RISK FACTORS

There have been no material changes from those risk factors previously disclosed in "ITEM 1A. RISK FACTORS" of Part I of Peoples' 2013 Form 10-K. Those risk factors are not the only risks Peoples faces. Additional risks and uncertainties not currently known to management or that management currently deems to be immaterial also may materially adversely affect Peoples' business, financial condition and/or operating results.

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

The following table details repurchases by Peoples and purchases by "affiliated purchasers" as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended, of Peoples' shares during the three months ended June 30, 2014:

Period	(a) Total Number of Shares Purchased		(b) Average Price Paid per Share		(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs [1]	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs [1]
April 1 - 30, 2014	—	[2]	$—	[2]	—	—
May 1 - 31, 2014	690	[2]	$24.60	[2]	—	—
June 1 - 30, 2014	85	[2]	$26.54	[2]	—	—
Total	775		$24.81		—	—

(1) Peoples' Board of Directors has not authorized any stock repurchase plans or programs for 2014.

(2) Information reflects solely shares purchased in open market transactions by Peoples Bank under the Rabbi Trust Agreement establishing a rabbi trust that holds assets to provide funds for the payment of the benefits under the Peoples Bancorp Inc. Third Amended and Restated Deferred Compensation Plan for Directors of Peoples Bancorp Inc. and Subsidiaries.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The exhibits required to be filed or furnished with this Form 10-Q are attached hereto or incorporated herein by reference. For a list of such exhibits, see "Exhibit Index" beginning at page 54.

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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.

PEOPLES BANCORP INC.

Date: July 24, 2014

By: /s/ CHARLES W. SULERZYSKI
Charles W. Sulerzyski
President and Chief Executive Officer

Date: July 24, 2014

By: /s/ EDWARD G. SLOANE
Edward G. Sloane
Executive Vice President,
Chief Financial Officer and Treasurer

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EXHIBIT INDEX

PEOPLES BANCORP INC. QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

Exhibit Number	Description	Exhibit Location
2.1	Agreement and Plan of Merger, dated as of April 4, 2014, between Peoples Bancorp Inc. and Ohio Heritage Bancorp, Inc.*	Incorporated herein by reference to Exhibit 2.1 to Current Report on Form 8-K of Peoples Bancorp Inc. ("Peoples") dated April 7, 2014 and filed with the SEC on the same date (File No. 0-16772)
2.2	Agreement and Plan of Merger, dated as of April 21, 2014, among Peoples Bancorp Inc., Peoples Bank, National Association and North Akron Savings Bank*	Incorporated herein by reference to Exhibit 2.1 to Peoples' Current Report on Form 8-K dated April 24, 2014 and filed with the SEC on the same date (File No. 0-16772)
3.1(a)	Amended Articles of Incorporation of Peoples Bancorp Inc. (as filed with the Ohio Secretary of State on May 3, 1993)	Incorporated herein by reference to Exhibit 3(a) to Peoples' Registration Statement on Form 8-B filed July 20, 1993 (File No. 0-16772)
3.1(b)	Certificate of Amendment to the Amended Articles of Incorporation of Peoples Bancorp Inc. (as filed with the Ohio Secretary of State on April 22, 1994)	Incorporated herein by reference to Exhibit 3(a)(2) to Peoples' Annual Report on Form 10-K for the fiscal year ended December 31, 1997 (File No. 0-16772) ("Peoples' 1997 Form 10-K")
3.1(c)	Certificate of Amendment to the Amended Articles of Incorporation of Peoples Bancorp Inc. (as filed with the Ohio Secretary of State on April 9, 1996)	Incorporated herein by reference to Exhibit 3(a)(3) to Peoples' 1997 Form 10-K
3.1(d)	Certificate of Amendment to the Amended Articles of Incorporation of Peoples Bancorp Inc. (as filed with the Ohio Secretary of State on April 23, 2003)	Incorporated herein by reference to Exhibit 3(a) to Peoples' Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2003 (File No. 0-16772) ("Peoples' March 31, 2003 Form 10-Q")
3.1(e)	Certificate of Amendment by Shareholders to the Amended Articles of Incorporation of Peoples Bancorp Inc. (as filed with the Ohio Secretary of State on January 22, 2009)	Incorporated herein by reference to Exhibit 3.1 to Peoples' Current Report on Form 8-K dated January 23, 2009 and filed with the SEC on the same date (File No. 0-16772)
3.1(f)	Certificate of Amendment by Directors to Articles filed with the Secretary of State of the State of Ohio on January 28, 2009, evidencing adoption of amendments by the Board of Directors of Peoples Bancorp Inc. to Article FOURTH of	Incorporated herein by reference to Exhibit 3.1 to Peoples' Current Report on Form 8-K dated February 2, 2009 and filed with the SEC on the same date (File No. 0-16772)

	Amended Articles of Incorporation to establish express terms of Fixed Rate Cumulative Perpetual Preferred Shares, Series A, each without par value, of Peoples Bancorp Inc.	
3.1(g)	Amended Articles of Incorporation of Peoples Bancorp Inc. (reflecting all amendments) [For SEC reporting compliance purposes only – not filed with Ohio Secretary of State]	Incorporated herein by reference to Exhibit 3.1(g) to Peoples' Annual Report on Form 10-K for the fiscal year ended December 31, 2008 (File No. 0-16772)
3.2(a)	Code of Regulations of Peoples Bancorp Inc.	Incorporated herein by reference to Exhibit 3(b) to Peoples' Registration Statement on Form 8-B filed July 20, 1993 (File No. 0-16772)
3.2(b)	Certified Resolutions Regarding Adoption of Amendments to Sections 1.03, 1.04, 1.05, 1.06, 1.08, 1.10, 2.03(C), 2.07, 2.08, 2.10 and 6.02 of the Code of Regulations of Peoples Bancorp Inc. by shareholders on April 10, 2003	Incorporated herein by reference to Exhibit 3(c) to Peoples' March 31, 2003 Form 10-Q

* Schedules and exhibits have been omitted pursuant to Item 601(b)(2) of SEC Regulation S-K. A copy of any omitted schedules or exhibits will be furnished supplementally to the SEC upon its request.

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EXHIBIT INDEX

PEOPLES BANCORP INC. QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

Exhibit Number	Description	Exhibit Location
3.2(c)	Certificate regarding adoption of amendments to Sections 3.01, 3.03, 3.04, 3.05, 3.06, 3.07, 3.08 and 3.11 of the Code of Regulations of Peoples Bancorp Inc. by shareholders on April 8, 2004	Incorporated herein by reference to Exhibit 3(a) to Peoples' Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004 (File No. 0-16772)
3.2(d)	Certificate regarding adoption of amendments to Sections 2.06, 2.07, 3.01 and 3.04 of Peoples Bancorp Inc.'s Code of Regulations by the shareholders on April 13, 2006	Incorporated herein by reference to Exhibit 3.1 to Peoples' Current Report on Form 8-K dated April 14, 2006 and filed with the SEC on the same date(File No. 0-16772)
3.2(e)	Certificate regarding adoption of an amendment to Section 2.01 of Peoples Bancorp Inc.'s Code of Regulations by the shareholders on April 22, 2010	Incorporated herein by reference to Exhibit 3.2(e) to Peoples' Quarterly Report on Form 10-Q/A (Amendment No. 1) for the quarterly period ended June 30, 2010 (File No. 0-16772) ("Peoples' June 30, 2010 Form 10-Q/A")
3.2(f)	Code of Regulations of Peoples Bancorp Inc. (reflecting all amendments) [For SEC reporting compliance purposes only]	Incorporated herein by reference to Exhibit 3.2(f) to Peoples' June 30, 2010 Form 10-Q/A
10.1	Peoples Bancorp Inc. Employee Stock Purchase Plan	Incorporated herein by reference to Exhibit 10.1 to Peoples' Current Report on Form 8-K dated April 28, 2014 and filed with the SEC on the same date (File No. 0-16772)
10.2	Peoples Bancorp Inc. Third Amended and Restated Deferred Compensation Plan for Directors of Peoples Bancorp Inc. and Subsidiaries	Filed herewith
31.1	Rule 13a-14(a)/15d-14(a) Certifications [President and Chief Executive Officer]	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certifications [Executive Vice President, Chief Financial Officer and Treasurer]	Filed herewith
32	Section 1350 Certifications	Furnished herewith
101.INS	XBRL Instance Document	Submitted electronically herewith #
101.SCH	XBRL Taxonomy Extension Schema Document	Submitted electronically herewith #
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Submitted electronically herewith #

101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Submitted electronically herewith #
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Submitted electronically herewith #
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Submitted electronically herewith #

Attached as Exhibit 101 to the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2014 of Peoples Bancorp Inc. are the following documents formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets (unaudited) at June 30, 2014 and December 31, 2013; (ii) Consolidated Statements of Income (unaudited) for the three and six months ended June 30, 2014 and 2013; (iii) Consolidated Statements of Comprehensive Income (unaudited) for the three and six months ended June 30, 2014 and 2013; (iv) Consolidated Statement of Stockholders' Equity (unaudited) for the six months ended June 30, 2014; (v) Condensed Consolidated Statements of Cash Flows (unaudited) for the six months ended June 30, 2014 and 2013; and (vi) Notes to the Unaudited Consolidated Financial Statements.