CITIZENS FINANCIAL SERVICES INC
Form 10-Q
November 08, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

Or

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

For the transition period from____________________ to __________________

Commission file number 0-13222

CITIZENS FINANCIAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

PENNSYLVANIA **23-2265045**
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

15 South Main Street
Mansfield, Pennsylvania 16933
(Address of principal executive offices)(Zip Code)

Registrant's telephone number, including area code: (570) 662-2121

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes __X__ No_____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (See definition of "accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act) Check one:

Large Accelerated File ____ Accelerated Filer ____ Non-accelerated Filer __X__

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

The number of shares outstanding of the Registrant's Common Stock, as of October 31, 2007, was 2,835,104 of Common Stock, par value $1.00.

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

(in thousands except share data)	**September 30 2007**	December 31 2006
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	**$ 10,468**	$ 10,007
Interest-bearing	**13**	8
Total cash and cash equivalents	**10,481**	10,015
Available-for-sale securities	**117,787**	109,743
Loans (net of allowance for loan losses:		
2007, $4,112 and 2006, $3,876)	**415,328**	410,897
Premises and equipment	**12,627**	12,892
Accrued interest receivable	**2,784**	2,458
Goodwill	**8,605**	8,605
Bank owned life insurance	**8,293**	8,047
Other assets	**8,217**	9,511
TOTAL ASSETS	**$ 584,122**	**$** 572,168
LIABILITIES:		
Deposits:		
Noninterest-bearing	**$ 53,867**	$ 48,509
Interest-bearing	**410,869**	398,006
Total deposits	**464,736**	446,515
Borrowed funds	**66,593**	75,775
Accrued interest payable	**2,029**	2,287
Other liabilities	**4,296**	4,091
TOTAL LIABILITIES	**537,654**	528,668
STOCKHOLDERS' EQUITY:		
Common stock		
$1.00 par value; authorized 10,000,000 shares;		
issued 3,020,537 shares in 2007 and 2,992,896 in 2006, respectively	**3,021**	2,993
Additional paid-in capital	**12,511**	11,933
Retained earnings	**36,399**	34,007
Accumulated other comprehensive loss	**(1,426)**	(1,737)
Unearned restricted stock: 2,785 shares for 2007 and 0 shares for 2006	**(65)**	-
Treasury stock, at cost: 185,433 shares for		
2007, and 172,954 shares for 2006	**(3,972)**	(3,696)
TOTAL STOCKHOLDERS' EQUITY	**46,468**	43,500
TOTAL LIABILITIES AND		
STOCKHOLDERS' EQUITY	**$ 584,122**	$ 572,168

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

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	**2007**	2006	**2007**	2006
INTEREST INCOME:				
Interest and fees on loans	**$ 7,715**	$ 7,226	**$ 22,611**	$ 20,639
Interest-bearing deposits with banks	**4**	-	**4**	-
Investment securities:				
Taxable	**1,130**	851	**3,201**	2,549
Nontaxable	**242**	232	**691**	679
Dividends	**88**	74	**257**	223
TOTAL INTEREST INCOME	**9,179**	8,383	**26,764**	24,090
INTEREST EXPENSE:				
Deposits	**3,366**	3,067	**10,106**	8,390
Borrowed funds	**928**	849	**2,660**	2,388
TOTAL INTEREST EXPENSE	**4,294**	3,916	**12,766**	10,778
NET INTEREST INCOME	**4,885**	4,467	**13,998**	13,312
Provision for loan losses	**60**	105	**225**	225
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**4,825**	4,362	**13,773**	13,087
NON-INTEREST INCOME:				
Service charges	**809**	827	**2,369**	2,342
Trust	**123**	135	**387**	372
Brokerage and Insurance	**37**	77	**86**	230
Investment securities gains	**24**	5	**24**	4
Gains on loans sold	**18**	11	**82**	24
Gains on sales of foreclosed properties	**-**	-	**396**	47
Earnings on bank owned life insurance	**84**	78	**246**	224
Other	**83**	80	**306**	293
TOTAL NON-INTEREST INCOME	**1,178**	1,213	**3,896**	3,536
NON-INTEREST EXPENSES:				
Salaries and employee benefits	**2,130**	2,055	**6,256**	6,078
Occupancy	**268**	261	**877**	845
Furniture and equipment	**137**	146	**405**	442
Professional fees	**149**	125	**469**	371
Amortization	**36**	36	**108**	216
Other	**1,068**	1,075	**3,406**	3,374
TOTAL NON-INTEREST EXPENSES	**3,788**	3,698	**11,521**	11,326
Income before provision for income taxes	**2,215**	1,877	**6,148**	5,297
Provision for income taxes	**461**	329	**1,254**	987
NET INCOME	**$ 1,754**	$ 1,548	**$ 4,894**	$ 4,310
Earnings Per Share	**$ 0.62**	$ 0.54	**$ 1.72**	$ 1.50
Cash Dividends Paid Per Share	**$ 0.225**	$ 0.215	**$ 0.670**	$ 0.640
Weighted average number of shares outstanding	**2,835,546**	2,863,404	**2,842,115**	2,877,852

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

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)	Three Months Ended September 30, **2007**	2006	Nine Months Ended September 30, **2007**	2006
Net income	**$ 1,754**	$ 1,548	**$ 4,894**	$ 4,310
Other comprehensive income:				
Unrealized losses on available for sale securities	**1,674**	2,035	**440**	796
Change in Unrecognized Pension Costs	**55**	-	**55**	-
Less: Reclassification adjustment for gains included in net income	**(24)**	(5)	**(24)**	(4)
Other comprehensive loss before tax	**1,705**	2,030	**471**	792
Income tax benefit related to other comprehensive income	**580**	690	**160**	269
Other comprehensive loss, net of tax	**1,125**	1,340	**311**	523
Comprehensive income	**$ 2,879**	$ 2,888	**$ 5,205**	$ 4,833

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

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

(in thousands)	Nine Months Ended September 30, **2007**	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 4,894**	$ 4,310
Adjustments to reconcile net income to net		
cash provided by operating activities:		
Provision for loan losses	**225**	225
Depreciation and amortization	**554**	902
Amortization and accretion of investment securities	**115**	312
Deferred income taxes	**28**	(73)
Investment securities gains, net	**(24)**	(4)
Realized gains on loans sold	**(82)**	(24)
Earnings on bank owned life insurance	**(246)**	(224)
Losses on premises and equipment	**100**	1
Originations of loans held for sale	**(4,581)**	(1,847)
Proceeds from sales of loans held for sale	**4,663**	1,871
Gains on sale of foreclosed assets held for sale	**(396)**	(47)
Decrease in accrued interest receivable	**(326)**	(243)
Decrease (increase) in accrued interest payable	**(258)**	132
Other, net	**222**	(59)
Net cash provided by operating activities	**4,888**	5,232
CASH FLOWS FROM INVESTING ACTIVITIES:		
Available-for-sale securities:		
Proceeds from sales of available-for-sale securities	**4,538**	10,402
Proceeds from maturity and principal repayments of securities	**9,342**	13,952
Purchase of securities	**(21,598)**	(25,322)
Proceeds from redemption of Regulatory Stock	**2,758**	2,204
Purchase of Regulatory Stock	**(2,316)**	(2,679)
Net increase in loans	**(4,604)**	(29,414)
Purchase of premises and equipment	**(418)**	(828)
Proceeds from sale of foreclosed assets held for sale	**1,075**	321
Net cash used in investing activities	**(11,223)**	(31,364)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	**18,222**	18,360
Proceeds from long-term borrowings	**16,647**	8,458
Repayments of long-term borrowings	**(3,647)**	(4,719)
Net increase (decrease) in short-term borrowed funds	**(22,183)**	7,882
Purchase of Treasury Stock	**(360)**	(996)
Reissuance of Treasury Stock	**13**	-
Vesting of Restricted Stock	**7**	-
Dividends paid	**(1,898)**	(1,820)
Net cash provided by financing activities	**6,801**	27,165

Net increase in cash and cash equivalents		**466**		1,033
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		**10,015**		8,609
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$**	**10,481**	$	9,642
Supplemental Disclosures of Cash Flow Information:				
Interest paid	**$**	**13,023**	$	10,613
Income taxes paid	**$**	**1,035**	$	1,170
Loans transferred to foreclosed property	**$**	**61**	$	463

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

CITIZENS FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

Citizens Financial Service, Inc., (individually and collectively with its direct and indirect subsidiaries, the "Company") is a Pennsylvania corporation organized as the holding company of its wholly owned subsidiary, First Citizens National Bank (the "Bank"), and its subsidiary, First Citizens Insurance Agency, Inc. ("First Citizens Insurance"). All material inter-company balances and transactions have been eliminated in consolidation.

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

In the opinion of management of the Company, the accompanying interim financial statements for the quarters ended September 30, 2007 and 2006 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the period. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. The financial performance reported for the Company for the nine-month period ended September 30, 2007 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Company's Annual Report on Form 10-K for the period ended December 31, 2006.

Note 2 - Earnings per Share

The following table sets forth the computation of earnings per share. Earnings per share calculations give retroactive effect to stock dividends declared by the Company. The Company has no dilutive securities.

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	**2007**	2006
Net income applicable to common stock	**$ 1,754,000**	$ 1,548,000	**$ 4,894,000**	$ 4,310,000
Weighted average common shares outstanding	**2,835,546**	2,863,404	**2,842,115**	2,877,852
Earnings per share	**$ 0.62**	$ 0.54	**$ 1.72**	$ 1.50

Note 3 - Income Tax Expense

Income tax expense is less than the amount calculated using the statutory tax rate, primarily the result of tax-exempt income earned from state and municipal securities, bank owned life insurance, and loans and investments in tax credits.

Note 4 - Employee Benefit Plans

For a detailed disclosure on the Company's pension and employee benefits plans, please refer to Note 10 of the Company's Consolidated Financial Statements included in the 2006 Annual Report on Form 10-K.

Defined Benefit Plan

The following sets forth the components of net periodic benefit costs of the noncontributory defined benefit plan for the three months and nine months ended September 30, 2007 and 2006, respectively:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2007**	2006	**2007**	2006
Service cost	**$ 100**	$ 105	**$ 322**	$ 283
Interest cost	**97**	98	**311**	264
Expected return on plan assets	**(112)**	(107)	**(358)**	(288)
Net amortization and deferral	**18**	23	**56**	63
Net periodic benefit cost	**$ 103**	$ 119	**$ 331**	$ 322

The Company expects to contribute $370,029 to its noncontributory defined benefit pension plan in 2007. As of September 30, 2007, the Company has contributed $198,433.

Defined Contribution Plan

The Company also sponsors a defined contribution, 401(k) plan covering substantially all of its employees. The Company contributes three percent of applicable salaries into the plan. Contributions totaled $149,000 and $141,000 for the nine months ended September 30, 2007 and 2006, respectively.

Note 5 – Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48 (“FIN 48”), *Accounting for Uncertainty in Income Taxes*. FIN 48 is an interpretation of FAS No. 109, *Accounting for Income Taxes*, and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN No. 48 requires expanded disclosure with respect to the uncertainty in income taxes and is effective for fiscal years beginning after December 15, 2006. The adoption of this standard is not expected to have a material effect on the Company’s financial position.

In September 2006, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 06-5(“EITF 06-5”), *Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance*. EITF 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF 06-5 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact the adoption of the EITF will have on the Company’s financial condition.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (“SAB 108”), *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*, providing guidance on quantifying financial statement misstatement and implementation when first applying this guidance. Under SAB No. 108, companies should evaluate a misstatement based on its impact on the current year income statement, as well as the cumulative effect of correcting such misstatements that existed in prior years existing in the current year's ending balance sheet. SAB 108 is effective for fiscal years ending after November 15, 2006. The adoption of this standard is not expected to have a material effect on the Company’s financial position.

In March 2007, the FASB ratified Emerging Issues Task Force Issue No. 06-10 (“EITF 06-10”), *Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements*. EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact the adoption of the EITF will have on the Company’s results of operations or financial condition.

In June 2007, the FASB ratified Emerging Issues Task Force Issue No. 06-11 (“EITF 06-11”), *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards*. EITF 06-11 applies to share-based payment arrangements with dividend protection features that entitle employees to receive (a) dividends on equity-classified non-vested shares, (b) dividend equivalents on equity-classified non-vested share units, or (c) payments equal to the dividends paid on the underlying shares while an equity-classified share option is outstanding, when those dividends or dividend equivalents are charged to retained earnings under FAS No. 123R, *Share-Based Payment*, and result in an income tax deduction for the employer. A consensus was reached that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity-classified non-vested equity shares, non-vested equity share units, and outstanding equity share options should be recognized as an increase in additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of the EITF will have on the Company’s financial condition.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement

Forward-looking statements may prove inaccurate. We have made forward-looking statements in this document, and in documents that we incorporate by reference, that are subject to risks and uncertainties. Forward-looking statements include information concerning possible or assumed future results of operations of the Company, the Bank, First Citizens Insurance or the combined company. When we use such words as "believes," "expects," "anticipates," or similar expressions, we are making forward-looking statements. For a variety of reasons, actual results could differ materially from those contained in or implied by forward-looking statements. The Company would like to caution readers that the following important factors, among others, may have affected and could in the future affect the Company's actual results and could cause the Company's actual results for subsequent periods to differ materially from those expressed in any forward looking statement:

- Interest rates could change more rapidly or more significantly than we expect.
- The economy could change significantly in an unexpected way, which would cause the demand for new loans and the ability of borrowers to repay outstanding loans to change in ways that our models do not anticipate.
- The stock and bond markets could suffer a significant disruption, which may have a negative effect on our financial condition and that of our borrowers, and on our ability to raise money by issuing new securities.
- It could take us longer than we anticipate implementing strategic initiatives designed to increase revenues or manage expenses, or we may be unable to implement those initiatives at all.
- Acquisitions and dispositions of assets could affect us in ways that management has not anticipated.
- We may become subject to new legal obligations or the resolution of litigation may have a negative effect on our financial condition.
- We may become subject to new and unanticipated accounting, tax, or regulatory practices, regulations or requirements, including the costs of compliance with such changes.
- We could experience greater loan delinquencies than anticipated, adversely affecting our earnings and financial condition. We could also experience greater losses than expected due to the ever increasing volume of information theft and fraudulent scams impacting our customers and the banking industry.
- We could lose the services of some or all of our key personnel, which would negatively impact our business because of their business development skills, financial expertise, lending experience, technical expertise and market area knowledge.

Except as required by applicable law and regulation, we assume no obligation to update or revise any forward-looking statements after the date on which they are made.

Introduction

The following is management's discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in its accompanying consolidated financial statements for the Company, a bank holding company and its direct and indirect subsidiaries. Our Company's consolidated financial condition and results of operations consist almost entirely of our wholly owned subsidiary's (the Bank) financial conditions and results of operations. Management's discussion and analysis should be read in conjunction with the preceding September 30, 2007 financial information. The results of operations for the three months and nine months ended September 30, 2007 and 2006 are not necessarily indicative of the results you may expect for the full year.

Our Company currently engages in the general business of banking throughout our service area of Potter, Tioga and Bradford counties in North Central Pennsylvania and Allegany, Steuben, Chemung and Tioga counties in Southern New York. We maintain our central office in Mansfield, Pennsylvania. Presently we operate 16 banking facilities. In

Pennsylvania, these offices are located in Mansfield, Blossburg, Ulysses, Genesee, Wellsboro, Troy, Sayre, Canton, Gillett, Millerton, LeRaysville, Towanda, the Wellsboro Weis Market store, and the Mansfield Wal-Mart Super Center. In New York, we have a branch office in Wellsville, Allegany County.

Risk identification and management are essential elements for the successful management of the Company. In the normal course of business, the Company is subject to various types of risk, including interest rate, credit, liquidity and regulatory risk.

Interest rate risk is the sensitivity of net interest income and the market value of financial instruments to the direction and frequency of changes in interest rates. Interest rate risk results from various re-pricing frequencies and the maturity structure of the financial instruments owned by the Company. The Company uses its asset/liability and funds management policy to control and manage interest rate risk.

Credit risk represents the possibility that a customer may not perform in accordance with contractual terms. Credit risk results from loans with customers and the purchasing of securities. The Company's primary credit risk is in the loan portfolio. The Company manages credit risk by adhering to an established credit policy and through a disciplined evaluation of the adequacy of the allowance for loan losses. Also, the investment policy limits the amount of credit risk that may be taken in the investment portfolio.

Liquidity risk represents the inability to generate or otherwise obtain funds at reasonable rates to satisfy commitments to borrowers and obligations to depositors. The Company has established guidelines within its asset/liability and funds management policy to manage liquidity risk. These guidelines include, among other things, contingent funding alternatives.

Regulatory risk represents the possibility that a change in law, regulations or regulatory policy may have a material effect on the business of the Company and its direct and indirect subsidiaries. We cannot predict what legislation might be enacted or what regulations might be adopted, or if adopted, the effect thereof on our operations.

Readers should carefully review the risk factors described in other documents our Company files from time to time with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the year ended December 31, 2006, filed by our Company and any current reports on Form 8-K filed by us.

We face strong competition in the communities that we serve from other commercial banks, savings banks, and savings and loan associations, some of which are substantially larger institutions than our subsidiary. In addition, insurance companies, investment-counseling firms, and other business firms and individuals offer personal and corporate trust services. We also compete with credit unions, issuers of money market funds, securities brokerage firms, consumer finance companies, mortgage brokers and insurance companies. These entities are strong competitors for virtually all types of financial services. The financial services industry continues to experience tremendous change to competitive barriers between bank and non-bank institutions. We must compete not only with traditional financial institutions, but in addition, with other business corporations that have begun to deliver competing financial services, and banking services that are easily accessible through the internet. Competition for banking services is based on price, nature of product, quality of service, and in the case of certain activities, convenience of location.

Trust and Investment Services

Our Investment and Trust Services Department is committed to helping our customers meet their financial goals. The Trust Department offers professional trust administration, investment management services, estate planning and administration, and custody of securities. We also help the members of our communities prepare for retirement by providing retirement plans for local employers and by managing individual IRA accounts. Assets held by the Company in a fiduciary or agency capacity for its customers are not included in the consolidated financial statements since such items are not assets of the Company. As of September 30, 2007 and December 31, 2006, the Trust Department had $93.7 million and $82.6 million of assets under management, respectively.

Our Investment Representatives offer full service brokerage services throughout the Bank's market area, and appointments can be made at any Bank branch. The Investment Representatives provide financial planning and help our customers achieve their financial goals with their choice of mutual funds, annuities, health and life insurance. These products are made available through our insurance subsidiary, First Citizens Insurance.

Results of Operations

Overview of the Income Statement

The Company had net income of $4,894,000 for the first nine months of 2007 compared with earnings of $4,310,000 for last year's comparable period, an increase of $584,000 or 13.5%. Earnings per share for the first nine months of 2007 were $1.72, compared to $1.50 last year representing a 14.7% increase. Annualized return on assets and return on equity for the first nine months of 2007 was 1.13% and 14.08%, respectively, compared with 1.06% and 13.18% for last year's comparable period.

Net income for the three months ended September 30, 2007 totaled $1,754,000 compared with $1,548,000 for the comparable period last year, an increase of $206,000 or 13.3%. Earnings per share for the three months ended September 30, 2007 and 2006 were $.62 and $.54 per share, an increase of 14.8%, respectively. Annualized return on assets and return on equity for the quarter ended September 30, 2007 was 1.20% and 14.85%, respectively, compared with 1.12% and 14.03%, respectively, for last year's comparable period.

Details of the reasons for these changes are discussed on the following pages.

Net Interest Income

Net interest income, the most significant component of earnings, is the amount by which interest income generated from interest-earning assets exceeds interest expense on interest-bearing liabilities.

For the three months ended September 30, 2007, net interest income was $4,885,000, which was $418,000 or 9.4% higher than the comparable period last year. The provision for loan losses was $60,000 for the three months ended September 30, 2007 compared with $105,000 for the same period last year. As such, net interest income after the provision for loan losses was $4,825,000 compared with $4,362,000 for the quarters ended September 30, 2007 and 2006, respectively.

Net interest income, for the nine months of 2007, was $13,998,000 compared to $13,312,000 for the same period in 2006. For the first nine months of 2007, the provision for loan losses totaled $225,000, the same as the first nine months of 2006. Consequently, net interest income after the provision for loan losses was $13,773,000 for the first nine months of 2007 compared to $13,087,000 for the first nine months of 2006, an increase of $686,000.

The following tables set forth the average balances of, and the interest earned or incurred on, each principal category of assets, liabilities and stockholders' equity, the related rates, net interest income and rate "spread" created for the three months and the nine months ended September 30, 2007 and 2006:

	Three Months Ended					
	September 30, 2007			September 30, 2006		
(dollars in thousands)	**Average Balance (1) $**	**Interest $**	**Average Rate %**	Average Balance (1) $	Interest $	Average Rate %
ASSETS						
Short-term investments:						
Interest-bearing deposits at banks	**357**	**4**	**4.45**	2	-	-
Total short-term investments	**357**	**4**	**4.45**	2	-	-
Investment securities:						
Taxable	**99,153**	**1,228**	**4.95**	82,846	934	4.51
Tax-exempt (3)	**24,439**	**366**	**5.99**	23,483	352	6.00
Total investment securities	**123,592**	**1,594**	**5.16**	106,329	1,286	4.84
Loans:						
Residential mortgage loans	**210,158**	**3,938**	**7.43**	212,368	3,822	7.14
Commercial & farm loans	**148,386**	**3,000**	**8.02**	137,578	2,672	7.71
Loans to state & political subdivisions	**45,758**	**700**	**6.07**	43,619	653	5.94
Other loans	**12,650**	**301**	**9.41**	12,671	288	9.05
Loans, net of discount (2)(3)(4)	**416,952**	**7,939**	**7.55**	406,236	7,435	7.26
Total interest-earning assets	**540,901**	**9,537**	**6.99**	512,567	8,721	6.75
Cash and due from banks	**9,674**			9,453		
Bank premises and equipment	**12,675**			12,382		
Other assets	**18,937**			18,856		
Total non-interest earning assets	**41,286**			40,691		
Total assets	**582,187**			553,258		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
NOW accounts	**100,949**	**571**	**2.24**	86,397	450	2.07
Savings accounts	**38,774**	**35**	**0.36**	39,561	34	0.34
Money market accounts	**50,487**	**461**	**3.62**	46,199	398	3.42
Certificates of deposit	**220,352**	**2,299**	**4.14**	220,048	2,185	3.94
Total interest-bearing deposits	**410,562**	**3,366**	**3.25**	392,205	3,067	3.10
Other borrowed funds	**68,111**	**928**	**5.40**	62,745	849	5.37
Total interest-bearing liabilities	**478,673**	**4,294**	**3.56**	454,950	3,916	3.42
Demand deposits	**50,373**			49,644		
Other liabilities	**6,990**			4,763		
Total non-interest-bearing liabilities	**57,363**			54,407		
Stockholders' equity	**46,151**			43,901		
	582,187			553,258		

Total liabilities & stockholders' equity		
Net interest income	**5,243**	4,805
Net interest spread (5)	**3.44%**	3.34%
Net interest income as a percentage of average interest-earning assets	**3.85%**	3.72%
Ratio of interest-earning assets to interest-bearing liabilities	**1.13**	1.13

(1) Averages are based on daily averages.
(2) Includes loan origination and commitment fees.
(3) Tax exempt interest revenue is shown on a tax equivalent basis for proper comparison using a statutory federal income tax rate of 34%.
(4) Income on non-accrual loans is accounted for on a cash basis, and the loan balances are included in interest-earning assets.
(5) Interest rate spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities.

	Nine Months Ended					
	September 30, 2007			September 30, 2006		
	Average Balance (1)	**Interest**	**Average Rate**	Average Balance (1)	Interest	Average Rate
(dollars in thousands)	**$**	**$**	**%**	$	$	%
ASSETS						
Short-term investments:						
Interest-bearing deposits at banks	**122**	**4**	**4.05**	11	-	1.70
Total short-term investments	**122**	**4**	**4.05**	11	-	1.70
Investment securities:						
Taxable	**95,491**	**3,488**	**4.87**	84,688	2,805	4.42
Tax-exempt (3)	**23,225**	**1,046**	**6.01**	23,065	1,029	5.95
Total investment securities	**118,716**	**4,534**	**5.09**	107,753	3,834	4.74
Loans:						
Residential mortgage loans	**211,249**	**11,675**	**7.39**	207,480	10,905	7.03
Commercial & farm loans	**146,646**	**8,692**	**7.92**	132,662	7,566	7.63
Loans to state & political subdivisions	**45,197**	**2,045**	**6.05**	43,400	1,936	5.96
Other loans	**12,308**	**855**	**9.29**	12,855	856	8.90
Loans, net of discount (2)(3)(4)	**415,400**	**23,267**	**7.49**	396,397	21,263	7.17
Total interest-earning assets	**534,238**	**27,805**	**6.96**	504,161	25,097	6.66
Cash and due from banks	**9,368**			8,993		
Bank premises and equipment	**12,827**			12,280		
Other assets	**18,984**			18,610		
Total non-interest earning assets	**41,179**			39,883		
Total assets	**575,417**			544,044		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
NOW accounts	**93,336**	**1,495**	**2.14**	84,514	1,176	1.86
Savings accounts	**38,446**	**101**	**0.35**	39,526	96	0.32
Money market accounts	**49,211**	**1,338**	**3.64**	45,056	1,036	3.07
Certificates of deposit	**228,959**	**7,172**	**4.19**	214,381	6,082	3.79
Total interest-bearing deposits	**409,952**	**10,106**	**3.30**	383,477	8,390	2.93
Other borrowed funds	**64,494**	**2,660**	**5.51**	63,935	2,388	4.99
Total interest-bearing liabilities	**474,446**	**12,766**	**3.60**	447,412	10,778	3.22
Demand deposits	**49,103**			48,592		
Other liabilities	**6,609**			4,665		
Total non-interest-bearing liabilities	**55,712**			53,257		
Stockholders' equity	**45,259**			43,375		
Total liabilities & stockholders' equity	**575,417**			544,044		
Net interest income		**15,039**			14,319	

Net interest spread (5)	**3.36%**	3.44%
Net interest income as a percentage		
of average interest-earning assets	**3.76%**	3.80%
Ratio of interest-earning assets		
to interest-bearing liabilities	**1.13**	1.13

(1) Averages are based on daily averages.
(2) Includes loan origination and commitment fees.
(3) Tax exempt interest revenue is shown on a tax equivalent basis for proper comparison using a statutory federal income tax rate of 34%.
(4) Income on non-accrual loans is accounted for on a cash basis, and the loan balances are included in interest-earning assets.
(5) Interest rate spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities.

Tax exempt revenue is shown on a tax-equivalent basis for proper comparison using a statutory, federal income tax rate of 34%. For purposes of the comparison, as well as the discussion that follows, this presentation facilitates performance comparisons between taxable and tax-free assets by increasing the tax-free income by an amount equivalent to the Federal income taxes that would have been paid if this income were taxable at the Company's 34% Federal statutory rate. The following table represents the adjustment to convert net interest income to net interest income on a fully taxable equivalent basis for the three and nine months ended September 30, 2007 and 2006:

In thousands:	For the Three Months Ended September 30, **2007**	2006	For the Nine Months Ended September 30, **2007**	2006
Total interest income	**$ 9,179**	$ 8,383	**$ 26,764**	$ 24,090
Total interest expense	**4,294**	3,916	**12,766**	10,778
Net interest income	**4,885**	4,467	**13,998**	13,312
Tax equivalent adjustment	**358**	338	**1,041**	1,007
Net interest income (fully taxable equivalent)	**$ 5,243**	$ 4,805	**$ 15,039**	$ 14,319

The following table shows the tax-equivalent effect of changes in volume and rate on interest income and expense for the three months and nine months ended September 30, 2007.

	Three months ended September 30, 2007 vs. 2006 (1)			Nine months ended September 30, 2007 vs. 2006 (1)		
(in thousands)	Change in Volume	Change in Rate	Total Change	Change in Volume	Change in Rate	Total Change
Interest Income:						
Short-term investments:						
Interest-bearing deposits at banks	$ 4	$ -	$ 4	$ 4	$ -	$ 4
Investment securities:						
Taxable	220	74	294	548	135	683
Tax-exempt	14	-	14	7	10	17
Total investments	234	74	308	555	145	700
Loans:						
Residential mortgage loans	(40)	156	116	192	578	770
Commercial & farm loans	228	100	328	848	278	1,126
Loans to state & political subdivisions	33	14	47	82	27	109
Other loans	(1)	14	13	(37)	36	(1)
Total loans, net of discount	220	284	504	1,085	919	2,004
Total Interest Income	458	358	816	1,644	1,064	2,708
Interest Expense:						
Interest-bearing deposits:						
NOW accounts	89	32	121	81	238	319
Savings accounts	(1)	2	1	(2)	7	5
Money Market accounts	43	20	63	78	224	302
Certificates of deposit	3	111	114	332	758	1,090
Total interest-bearing deposits	134	165	299	489	1,227	1,716

Other borrowed funds	73	6	79	20	252	272
Total interest expense	207	171	378	509	1,479	1,988
Net interest income	$ 251	$ 187	$ 438	$ 1,135	$ (415)	$ 720

(1) The portion of the total change attributable to both volume and rate changes during the year has been allocated
to volume and rate components based upon the absolute dollar amount of the change in each component prior to allocation.

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As can be seen from the preceding tables, our net interest spread improved from 3.34% for the three months ended September 30, 2006 to 3.44% for the same time period in 2007. For the first nine months of 2007, our net interest spread was 3.36% compared with 3.44% for the first nine months of 2006, a decrease of 8 basis points. From June 2004 to June 2006, the Federal Reserve increased the Federal Funds rate 425 basis points. Since that period, we have experienced a flat to inverted interest rate yield curve. This resulted in an increase in the rates paid on our shorter-term cost of funds. We did not however see the same level of increase in longer-term rates on our interest earning assets. As such, we experienced a compression in our net interest margin.

In August 2007, the Federal Reserve lowered the discount rate 50 basis points due primarily to a decrease in overall liquidity related to the sub-prime housing market. On September 18, 2007, due to various economic factors, the Federal Reserve reduced the Federal Funds rate by 50 basis points. For the quarter ended September 30, 2007, these events resulted in a slightly positive affect on the Company by decreasing our short-term cost of funds more than the decrease in interest income earned on shorter term interest earning assets. As such, our net interest spread has improved compared to the same period last year. If the yield curve becomes more normal, we expect our interest margin to continue to improve. Management continues to review various pricing and investment strategies in an attempt to maintain or improve upon our current interest margin. Low cost deposits continue to be our focus and are essential in improving the interest margin going forward.

For the three months ended September 30, 2007, tax equivalent net interest income increased from $4,805,000 in 2006 to $5,243,000. The yield on interest-earning assets was 6.99% compared to 6.75% and the rate on interest-bearing liabilities was 3.56% compared to 3.42%.

Tax equivalent net interest income improved from $14,319,000 for the nine months ended September 30, 2006 to $15,040,000 for the same period in 2007. This represents an increase of $721,000 on a tax equivalent basis. The increase in interest-earning assets of $30.1 million generated an increase in interest income of $2,708,000, with $1,644,000 due to volume, and $1,064,000 of the increase attributable to a change in rate. The yield on interest earning assets has increased 30 basis points going from 6.66% to 6.96%. Interest-bearing liabilities increased $27.0 million resulting in an increase of $1,988,000 of interest expense predominately attributable to a change in rate. Comparing the first nine months of 2007 with 2006, the average interest rate on interest-bearing liabilities increased 38 basis points, from 3.22% to 3.60%.

Provision For Loan Losses

For the three months ending September 30, 2007, we recorded $60,000 to the provision for loan losses compared to $105,000 recorded for the same time period last year. For the nine month period ending September 30, 2007 we recorded $225,000 to the provision which is the same as was recorded last year through nine months. Management's quarterly review of the allowance for loan losses is based on the following information: migration analysis of delinquent and non-accrual loans, impaired loans, estimated future losses on loans, recent review of large problem credits, local and national economic conditions, historical loss experience, OCC qualitative adjustments, actual and expected loan growth and peer comparisons (see also “Financial Condition – Allowance for Loan Losses”).

Non-interest Income

Non-interest income for the three months ended September 30, 2007, as detailed below, totaled $1,178,000, a decrease of $35,000 over the comparable period last year. The main decrease is in brokerage and insurance revenues which decreased by $40,000 when compared to last year. We continue the transition to a new broker-dealer. As a result, our focus has moved from annuity products to fee based managed accounts that will allow us to further develop our relationship with our customers. During the three months ended September 30, 2007, we recorded a $24,000 net gain on the sale of investment securities. This compares to a net gain of $5,000 recorded during the third quarter of 2006.

Non-interest income increased $360,000 or 10.2%, for the first nine months of 2007 when compared to the same period in 2006. Gains on sales of foreclosed properties increased by $349,000 due to a large pre-tax gain of $381,000 realized during the second quarter from the sale of a commercial property. Trust income increased $15,000 or 4.0% due to our ongoing success in growing our trust assets under management. Gains on the sale of investment securities increased by $20,000 due to the aforementioned sale. Gains on loans sold also increased $58,000 due to an increased volume of sales of secondary mortgages compared to last year. These increases were offset by a decrease in brokerage income of $144,000. We continue to emphasize the successful transition to the new broker-dealer and anticipate continued improvement.

The following tables show the breakdown of non-interest income for the three months and nine months ended September 30, 2007 and 2006:

	Three months ended September 30,		Change	
(dollars in thousands)	**2007**	2006	Amount	%
Service charges	**$ 809**	$ 827	$ (18)	(2.2)
Trust	**123**	135	(12)	(8.9)
Brokerage and Insurance	**37**	77	(40)	(51.9)
Investment securities gains, net	**24**	5	19	380.0
Gains on loans sold	**18**	11	7	63.6
Earnings on bank owned life insurance	**84**	78	6	7.7
Other	**83**	80	3	3.8
Total	**$ 1,178**	$ 1,213	$ (35)	(2.9)

	Nine months ended September 30,		Change	
(dollars in thousands)	**2007**	2006	Amount	%
Service charges	**$ 2,369**	$ 2,342	$ 27	1.2
Trust	**387**	372	15	4.0
Brokerage and Insurance	**86**	230	(144)	(62.6)
Investment securities gains, net	**24**	4	20	500.0
Gains on loans sold	**82**	24	58	241.7
Gains on sales of foreclosed properties	**396**	47	349	742.6
Earnings on bank owned life insurance	**246**	224	22	9.8
Other	**306**	293	13	4.4
Total	**$ 3,896**	$ 3,536	$ 360	10.2

Non-interest Expense

Non-interest expenses, as detailed below, totaled $3,788,000 for the three months ended September 30, 2007 compared with $3,698,000 for the comparable period last year. This is an increase of $90,000, or 2.4%. Salaries and employee benefits have increased by $75,000, or 3.6%, primarily due to an increase in employee incentive accruals. Professional fees increased $24,000 due to various consulting arrangements consistent with our strategic initiatives.

Total non-interest expense for the first nine months of 2007 increased $195,000 or 1.7%, compared to the same period in 2006. The increase is primarily due to a $100,000 write-down of one of our bank properties. The increase in salaries and employee benefits of $178,000 is due mainly to annual merit increases and an increase in employee incentive accruals. Occupancy expense increased by $32,000 because of the depreciation and associated building maintenance to our new Wellsville branch. Other professional fees have increased $98,000 over last year due to various consulting arrangements including an evaluation of our incentive and pension plans. Furniture and equipment costs decreased due to decreased depreciation expense from assets becoming fully depreciated. Amortization expense decreased $108,000 due to a core deposit intangible from a previous acquisition that became fully amortized in March 2006. Without the $100,000 write-down, we would have increased total non-interest expense by only $95,000, or 0.8% over the first nine months of 2007. Management continues to examine ways to become a more efficient organization without sacrificing customer service.

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The following tables reflect the breakdown of non-interest expense and professional fees for the three months and nine months ended September 30, 2007 and 2006:

(dollars in thousands)	Three months ended September 30, **2007**	2006	Change Amount	%
Salaries and employee benefits	**$ 2,130**	$ 2,055	$ 75	3.6
Occupancy	**268**	261	7	2.7
Furniture and equipment	**137**	146	(9)	(6.2)
Professional fees	**149**	125	24	19.2
Amortization	**36**	36	-	-
Other	**1,068**	1,075	(7)	(0.7)
Total	**$ 3,788**	$ 3,698	$ 90	2.4

	Three months ended September 30, **2007**	2006	Change Amount	%
Other professional fees	**$ 90**	$ 68	$ 22	32.4
Legal fees	**15**	21	(6)	(28.6)
Examinations and audits	**44**	36	8	22.2
Total	**$ 149**	$ 125	$ 24	19.2

(dollars in thousands)	Nine months ended September 30, **2007**	2006	Change Amount	%
Salaries and employee benefits	**$ 6,256**	$ 6,078	$ 178	2.9
Occupancy	**877**	845	32	3.8
Furniture and equipment	**405**	442	(37)	(8.4)
Professional fees	**469**	371	98	26.4
Amortization	**108**	216	(108)	(50.0)
Other	**3,406**	3,374	32	0.9
Total	**$ 11,521**	$ 11,326	$ 195	1.7

	Nine months ended September 30, **2007**	2006	Change Amount	%
Other professional fees	**$ 278**	$ 215	$ 63	29.3
Legal fees	**70**	50	20	40.0
Examinations and audits	**121**	106	15	14.2
Total	**$ 469**	$ 371	$ 98	26.4

Provision For Income Taxes

The provision for income taxes was $461,000 for the three months ending September 30, 2007 compared to $329,000 last year. The increase is due to the level of taxable income we have earned this year compared to last year.

The provision for income taxes was $1,254,000 for the nine month period ended September 30, 2007 compared to $987,000 for the same period in 2006. Through management of our municipal loan and bond portfolios, the effective tax rate for 2007 is 20.35% compared with 18.47% for last year.

We are involved in three limited partnership agreements that established low-income housing projects in our market areas. As a result of these agreements, for tax purposes we have recognized $639,000 out of a total $913,000 of tax credits from one project in the Towanda area that began in October of 2000. We have recognized $221,000 out of a total $385,000 of tax credits on the second project in the Wellsboro market which was completed in November 2001. In 2005, we entered into a third limited liability partnership for a low-income housing project for senior citizens in our Sayre market area. Beginning in 2007, we have recognized $43,000 out of a total $574,000 of tax credits. We anticipate recognizing $969,000 of tax credits over the next ten years.

Financial Condition

Total assets (shown in the Consolidated Balance Sheet) of $584.1 million have increased 2.1% since year-end 2006's balance of $572.2 million. Net loans have increased 1.1% to $415.3 million at September 30, 2007. Investment securities increased 7.4% to $117.8 million since year-end 2006. Total deposits increased $18.2 million or 4.1% to $464.7 million since year-end 2006. Borrowed funds have decreased $9.2 million to $66.6 million compared with $75.8 million at year-end. Explanations of variances will be described within the following appropriate sections.

Cash and Cash Equivalents

Cash and cash equivalents totaled $10,481,000 at September 30, 2007 compared to $10,015,000 on December 31, 2006. Non-interest-bearing cash increased $461,000 since year-end 2006, while interest-bearing cash increased $5,000 during that same period. We believe the liquidity needs of the Company are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable the Company to meet cash obligations and off-balance sheet commitments.

Investments

As shown in the table below, our investment portfolio increased by $8,044,000 or 7.3% from December 31, 2006 to September 30, 2007. During the first three quarters of 2007 we purchased approximately $11.4 million of U.S. agency obligations, $6.7 million of mortgage-backed securities, and $3.3 million of municipal bonds offsetting the $8.7 million of principal repayments that occurred during the same time period. We continue to receive monthly principal repayments allowing us to purchase at current market yields. We have increased our investment portfolio during the first nine months of the year primarily due to opportunities related to fluctuations in the treasury curve. Additionally, we sold $4.5 million of securities resulting in the $24,000 aforementioned gain. The overall market value of our investment portfolio has increased approximately $.4 million due to decreases in interest rates since year end. Our investment portfolio is currently yielding 5.10% compared to 4.75% a year ago, on a tax equivalent basis.

	September 30, 2007		December 31, 2006	
(dollars in thousands)	**Amount**	**%**	Amount	%
Available-for-sale:				
U. S. Agency securities	**$ 23,294**	**19.8**	$ 16,651	15.2
Obligations of state & political subdivisions	**25,725**	**21.8**	22,562	20.5
Corporate obligations	**7,778**	**6.6**	7,997	7.3
Mortgage-backed securities	**58,168**	**49.4**	59,875	54.6
Equity securities	**2,822**	**2.4**	2,658	2.4
Total	**$ 117,787**	**100.0**	$ 109,743	100.0

	September 30, 2007/ December 31, 2006 Change	
(dollars in thousands)	**Amount**	**%**
Available-for-sale:		
U. S. Agency securities	**$ 6,643**	**39.9**

Obligations of state & political subdivisions		**3,163**	**14.0**
Corporate obligations		**(219)**	**(2.7**
Mortgage-backed securities		**(1,707)**	**(2.9**
Equity securities		**164**	**6.2**
Total	**$**	**8,044**	**7.3**

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Management continues to monitor the earnings performance and the effectiveness of the liquidity of the investment portfolio on a regular basis. Through active balance sheet management and analysis of the securities portfolio, the Company maintains sufficient liquidity to satisfy depositor requirements and various credit needs of its customers.

Loans

The Company's lending is focused in the north central Pennsylvania market and the southern tier of New York. The composition of our loan portfolio consists principally of retail lending, which includes single-family residential mortgages and other consumer lending, and commercial lending primarily to locally owned small businesses. New loans are generated primarily from direct loans to our existing customer base, with new customers generated by referrals from real estate brokers, building contractors, attorneys, accountants and existing customers.

As shown in the tables below (dollars in thousands), total loans increased approximately $4,667,000 or 1.1% during the first nine months of 2007. The increase in commercial real estate loans of $4.2 million and the $2.3 million increase in commercial and other loans was offset by a $2.9 million decrease in residential real estate loans with minimal change in the other loan categories.

We have experienced an overall decrease in loan demand during the first nine months of 2007. Our focus continues to be on loan quality and customer relationships, which has impacted our growth during the first nine months due to local and regional economic conditions. The Company's focus remains on commercial lending as a means to increase loan growth as well as obtain deposits from farmers and small businesses throughout our market area. We have a strong team of dedicated, experienced professionals that enable us to meet the needs of commercial and agricultural customers within our service area. Residential mortgage lending is a principal business activity and our Company continues to offer a full menu of competitively priced conforming, nonconforming and home equity mortgages. We emphasize branch office personnel training and focus on providing flexibility and fast "turn around time" that will aid in growing our loan portfolio.

(dollars in thousands)	September 30, 2007 Amount	%	December 31, 2006 Amount	%
Real estate:				
Residential	**$ 203,133**	**48.4**	$ 206,059	49.7
Commercial	**98,360**	**23.5**	94,122	22.7
Agricultural	**16,758**	**4.0**	17,054	4.1
Construction	**7,160**	**1.7**	7,027	1.7
Loans to individuals				
for household, family and other purchases	**13,009**	**3.1**	12,482	3.0
Commercial and other loans	**35,111**	**8.4**	32,766	7.9
State & political subdivision loans	**45,909**	**10.9**	45,263	10.9
Total loans	**419,440**	**100.0**	414,773	100.0
Less allowance for loan losses	**4,112**		3,876	
Net loans	**$ 415,328**		$ 410,897	

(dollars in thousands)	September 30, 2007/ December 31, 2006 Change Amount	%
Real estate:		
Residential	**$ (2,926)**	**(1.4)**
Commercial	**4,238**	**4.5**
Agricultural	**(296)**	**(1.7)**
Construction	**133**	**1.9**
Loans to individuals		
for household, family and other purchases	**527**	**4.2**
Commercial and other loans	**2,345**	**7.2**
State & political subdivision loans	**646**	**1.4**
Total loans	**$ 4,667**	**1.1**

Allowance For Loan Losses

As shown in the table below, the Allowance for Loan Losses as a percentage of loans increased from .93% at December 31, 2006 to .98% at September 30, 2007. The dollar amount of the allowance increased $236,000 since year-end 2006. The increase is a result of a $225,000 provision for the first nine months, losses of $128,000, and recoveries of $139,000, which includes $79,000 from one large commercial relationship.

(dollars in thousands)	September 30, 2007	December 31, 2006	2005	2004	2003
Balance, at beginning of period	**$ 3,876**	$ 3,664	$ 3,919	$ 3,620	$ 3,621
Provision charged to income	**225**	330	60	-	435
Increase related to acquisition	**-**	-	-	290	-
Recoveries on loans previously					
charged against the allowance	**139**	172	57	324	116
	4,240	4,166	4,036	4,234	4,172

Loans charged against the allowance		**(128)**		(290)		(372)		(315)		(552)
Balance, at end of year	**$**	**4,112**	$	3,876	$	3,664	$	3,919	$	3,620
Allowance for loan losses as a percent										
of total loans		**0.98%**		0.93%		0.96%		1.09%		1.14%
Allowance for loan losses as a percent										
of non-performing loans		**172.27%**		115.43%		163.94%		176.53%		134.62%

The adequacy of the allowance for loan losses is subject to a formal analysis by management of the Company. Management deems the allowance to be adequate to absorb inherent losses probable in the portfolio, as of September 30, 2007. The Company has disclosed in its annual report on Form 10-K for the year ended December 31, 2006 the process and methodology supporting the loan loss provision.

Credit Quality Risk

The following table identifies amounts of loan losses and non-performing loans. Past due loans are those that were contractually past due 90 days or more as to interest or principal payments.

(dollars in thousands)	**September 30, 2007**	December 31, 2006	2005	2004	2003
Non-performing loans:					
Non-accruing loans	**$ 1,177**	$ 478	$ 867	$ 722	$ 578
Impaired loans	**989**	1,190	1,031	1,061	1,926
Accrual loans - 90 days or more past due	**221**	1,690	337	437	185
Total non-performing loans	**2,387**	3,358	2,235	2,220	2,689
Foreclosed assets held for sale	**140**	758	619	712	305
Total non-performing assets	**$ 2,527**	$ 4,116	$ 2,854	$ 2,932	$ 2,994
Non-performing loans as a percent of loans net of unearned income	**0.57%**	0.81%	0.58%	0.62%	0.85%
Non-performing assets as a percent of loans net of unearned income	**0.60%**	0.99%	0.75%	0.82%	0.94%

Interest does not accrue on non-accrual loans. Subsequent cash payments received are applied to the outstanding principal balance or recorded as interest income, depending upon management's assessment of its ultimate ability to collect principal and interest. The increase in non-accruing loans is mainly due to one large customer that was added in 2007. The decrease in accrual loans – 90 days or more past due for the first nine months is primarily due to a temporary delay in payment from one large commercial customer at December 31, 2006. The decrease in foreclosed assets held for sale is due to the aforementioned sale of a large commercial property. Overall, non-performing assets have decreased by $1,589,000 since December 31, 2006.

Bank Owned Life Insurance

The Company has purchased bank owned life insurance to offset future employee benefit costs. As of September 30, 2007 the cash surrender value of this life insurance is $8,293,000, an increase of $246,000 since year end. The use of life insurance policies provides the bank with an asset that will generate earnings to partially offset the current costs of benefits, and eventually (at the death of the insureds) provide partial recovery of cash outflows associated with the benefits.

Deposits

Traditional deposits continue to be the most significant source of funds for the Company. As shown in the following tables, deposits increased $18,221,000 or 4.1%, since December 31, 2006. As of September 30, 2007, non-interest-bearing deposits increased by $5,358,000, NOW accounts increased by $15,469,000, savings accounts increased $930,000, and money market deposit accounts increased $7,495,000. The large increase in NOW accounts and money market deposits was mainly due to increases in deposits of municipalities related primarily to real estate tax receipts during the first nine months of 2007. Brokered certificates of deposit decreased by $4,674,000. Due to the Federal Reserve's lowering of the Federal Funds rate 50 basis points in September, we have replaced maturing brokered certificates of deposit with short-term Federal Home Loan Bank borrowings in an effort to manage our overall cost of funds. Certificates of deposit have declined by $6,357,000, or 3.0% since year end 2006.

	September 30, 2007		December 31, 2006	
(dollars in thousands)	**Amount**	**%**	Amount	%
Non-interest-bearing deposits	**$ 53,867**	**11.6**	$ 48,509	10.9
NOW accounts	**101,536**	**21.8**	86,067	19.3
Savings deposits	**38,567**	**8.3**	37,637	8.4
Money market deposit accounts	**53,561**	**11.5**	46,066	10.3
Brokered certificates of deposit	**9,179**	**2.0**	13,853	3.1
Certificates of deposit	**208,026**	**44.8**	214,383	48.0
Total	**$ 464,736**	**100.0**	$ 446,515	100.0

	September 30, 2007/ December 31, 2006 Change	
(dollars in thousands)	**Amount**	**%**
Non-interest-bearing deposits	**$ 5,358**	**11.0**
NOW accounts	**15,469**	**18.0**
Savings deposits	**930**	**2.5**
Money market deposit accounts	**7,495**	**16.3**
Brokered certificates of deposit	**(4,674)**	**(33.7)**
Certificates of deposit	**(6,357)**	**(3.0)**
Total	**$ 18,221**	**4.1**

Borrowed Funds

Borrowed funds decreased $9,182,000 during the first nine months of 2007. The increase in deposits, offset by investment purchases, resulted in the net decrease compared to December 31, 2006. The Company's daily cash requirements or short-term investments are primarily met by using the financial instruments available through the Federal Home Loan Bank.

In December 2003, the Company formed a special purpose entity, Citizens Financial Statutory Trust I (“the Entity”), to issue $7,500,000 of floating rate obligated mandatory redeemable securities as part of a pooled offering. The rate is determined quarterly and floats based on the 3 month LIBOR plus 2.80%. At September 30, 2007, the rate was 8.49%. The Entity may redeem them, in whole or in part, at face value after December 17, 2008. The Company borrowed the proceeds of the issuance from the Entity in December 2003 in the form of a $7,500,000 note payable, which is included within borrowed funds in the liabilities section of the Company’s balance sheet. Under current accounting rules, the Company’s minority interest in the Entity was recorded at the initial investment amount and is included in the other assets section of the balance sheet. The Entity is not consolidated as part of the Company’s consolidated financial statements.

Stockholder’s Equity

We evaluate stockholders’ equity in relation to total assets and the risks associated with those assets. The greater the capital resource, the more likely a corporation is to meet its cash obligations and absorb unforeseen losses. For these reasons, capital adequacy has been, and will continue to be, of paramount importance.

Total Stockholders’ Equity was $46,468,000 at September 30, 2007 compared to $43,500,000, at December 31, 2006, an increase of $2,968,000 or 6.8%. Excluding accumulated other comprehensive loss, stockholder’s equity increased

$2,657,000, or 5.9%. In the first nine months of 2007, the Company had net income of $4,894,000 and paid dividends of $1,898,000, representing a dividend payout ratio of 38.8%. The Company also purchased 16,128 shares of treasury stock for $359,675 at a weighted average cost of $22.30 per share during the first nine months of 2007.

All of the Company's investment securities are classified as available-for-sale making this portion of the Company's balance sheet more sensitive to the changing market value of investments. Accumulated other comprehensive loss decreased $311,000 compared to December 31, 2006 as a result of market value fluctuations involving spreads and interest rate movements.

The Company has also complied with standards of being well capitalized mandated by the banking regulators. The Company's primary regulators have established "risk-based" capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks associated with various assets entities hold in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, or 100% (highest risk assets), is assigned to each asset on the balance sheet. The Company's computed risk-based capital ratios are as follows:

(dollars in thousand)	**September 30, 2007**		December 31, 2006	
Total capital (to risk-weighted assets)	Amount	Ratio	Amount	Ratio
Company	**$ 50,615**	**13.08%**	$ 47,604	12.59%
For capital adequacy purposes	**30,968**	**8.00%**	30,252	8.00%
To be well capitalized	**38,710**	**10.00%**	37,815	10.00%
Tier I capital (to risk-weighted assets)				
Company	**$ 46,449**	**12.00%**	$ 43,684	11.55%
For capital adequacy purposes	**15,484**	**4.00%**	15,126	4.00%
To be well capitalized	**23,226**	**6.00%**	22,689	6.00%
Tier I capital (to average assets)				
Company	**$ 46,449**	**8.10%**	$ 43,684	7.82%
For capital adequacy purposes	**22,938**	**4.00%**	22,355	4.00%
To be well capitalized	**28,672**	**5.00%**	27,944	5.00%

The Bank's computed risk-based capital ratios are as follows:

(dollars in thousand)	**September 30, 2007**		December 31, 2006	
Total capital (to risk-weighted assets)	Amount	Ratio	Amount	Ratio
Bank	**$ 44,557**	**11.53%**	$ 41,249	10.93%
For capital adequacy purposes	**30,927**	**8.00%**	30,200	8.00%
To be well capitalized	**38,659**	**10.00%**	37,750	10.00%
Tier I capital (to risk-weighted assets)				
Bank	**$ 40,383**	**10.45%**	$ 37,330	9.89%
For capital adequacy purposes	**15,464**	**4.00%**	15,100	4.00%
To be well capitalized	**23,196**	**6.00%**	22,650	6.00%
Tier I capital (to average assets)				
Bank	**$ 40,383**	**7.05%**	$ 37,330	6.68%
For capital adequacy purposes	**22,920**	**4.00%**	22,373	4.00%
To be well capitalized	**28,650**	**5.00%**	27,966	5.00%

Off Balance Sheet Activities

Some financial instruments, such as loan commitments, credit lines, and letters of credit are issued to meet customer financing needs. These commitments are made in the normal course of business with most of them expiring without ever being drawn upon. The contractual amount of financial instruments with off-balance sheet risk was as follows at September 30, 2007 (dollars in thousands):

Commitments to extend credit	$ 71,417
Standby letters of credit	2,077
	$ 73,494

Liquidity

Liquidity is a measure of our Company's ability to efficiently meet normal cash flow requirements of both borrowers and depositors. To maintain proper liquidity, we use funds management policies along with our investment policies to assure we can meet our financial obligations to depositors, credit customers and stockholders. Liquidity is needed to meet depositors' withdrawal demands, extend credit to meet borrowers' needs, provide funds for normal operating expenses and cash dividends, and to fund other capital expenditures.

Our Company's historical activity in this area can be seen in the Consolidated Statement of Cash Flows from investing and financing activities.

Cash generated by operating activities, investing activities and financing activities influences liquidity management. The most important source of funds is the deposits that are primarily core deposits (deposits from customers with other relationships). Short-term debt from the Federal Home Loan Bank supplements our Company’s availability of funds as well as line of credit arrangements with corresponding banks. Other sources of short-term funds include brokered certificates of deposit and the sale of loans or investments, if needed.

Our Company's use of funds is shown in the investing activity section of the Consolidated Statement of Cash Flows, where the net loan activity is presented. Other significant uses of funds include purchasing Regulatory Stock, as well as the purchase of capital expenditures. Surplus funds are then invested in investment securities.

Capital expenditures during the first nine months of 2007 were $418,000, less than the $828,000 that was expended for the same period last year.

Our Company achieves additional liquidity primarily from temporary or short-term borrowings from the Federal Home Loan Bank of Pittsburgh, PA, and other wholesale borrowing alternatives that mature in less than one year. The Company has a maximum borrowing capacity at the Federal Home Loan Bank of approximately $225.7 million as an additional source of liquidity, of which $39.7 million is outstanding. Additionally, the Company and the Bank have line of credit arrangements with corresponding banks that provide additional liquidity.

Interest Rate and Market Risk Management

The objective of interest rate sensitivity management is to maintain an appropriate balance between the stable growth of income and the risks associated with maximizing income through interest sensitivity imbalances and the market value risk of assets and liabilities.

Because of the nature of our operations, we are not subject to foreign currency exchange or commodity price risk and, since our Company has no trading portfolio, it is not subject to trading risk.

Currently, our Company has equity securities that represent only 2.4% of our investment portfolio and, therefore, market risk is not significant.

The primary components of interest-sensitive assets include adjustable-rate loans and investments, loan repayments, investment maturities and money market investments. The primary components of interest-sensitive liabilities include maturing certificates of deposit, IRA certificates of deposit and short-term borrowings. Savings deposits, NOW accounts and money market investor accounts are considered core deposits and are not short-term interest sensitive (except for the top-tier money market investor accounts which are paid current market interest rates).

Gap analysis, one of the methods used by us to analyze interest rate risk, does not necessarily show the precise impact of specific interest rate movements on our Company's net interest income because the re-pricing of certain assets and liabilities is discretionary and is subject to competitive and other pressures. In addition, assets and liabilities within the same period may, in fact, be repaid at different times and at different rate levels. We have not experienced the kind of earnings volatility that might be indicated from gap analysis.

Our Company currently uses a computer simulation model to better measure the impact of interest rate changes on net interest income. We use the model as part of our risk management process that will effectively identify, measure, and monitor our Company's risk exposure.

We use numerous interest rate simulations employing a variety of assumptions to evaluate our interest rate risk exposure. A shock analysis during the third quarter of 2007 indicated that a 200 basis point movement in interest rates in either direction would have a minor impact on our Company's anticipated net interest income over the next twenty-four months, and is within our Company’s policy limit to manage interest rate risk effectively.

Item 3-Quantitative and Qualitative Disclosure About Market Risk

In the normal course of conducting business activities, the Company is exposed to market risk, principally interest rate risk, through the operations of its banking subsidiary. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and values of financial instruments and was discussed previously in this Form 10-Q. Management and a committee of the Board of Directors manage interest rate risk (see also “Interest Rate and Market Risk Management”).

No material changes in market risk strategy occurred during the current period. A detailed discussion of market risk is provided in the SEC Form 10-K for the period ended December 31, 2006.

Item 4-Control and Procedures

We maintain a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, within 90 days prior to the filing date of this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic Securities and Exchange Commission filings. No significant changes were made to our internal controls or other factors during the quarter ended, September 30, 2007, that could significantly affect these controls subsequent to the date of their evaluation.

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

Management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of the Company. Any pending proceedings are ordinary, routine litigation incidental to the business of the Company and its subsidiary. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Company and its subsidiary by government authorities.

Item 1A – Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect our business, financial condition or future results. At September 30, 2007 the risk factors of the Company have not changed materially from those reported in our Annual Report on Form 10-K. However, the risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares (or units Purchased)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans of Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
7/1/07 to 7/31/07	-	-	-	91,211
8/1/07 to 8/30/07	5,000	$ 21.75	5,000	86,211
9/1/07 to 9/30/07	293	$ 22.00	293	85,918
Total	**5,293**	**$ 21.76**	**5,293**	**85,918**

(1) On January 7, 2006, the Board of Directors authorized the repurchase of 140,000 shares. The repurchase plan does not have an expiration date.

Item 3 - Defaults Upon Senior Securities

Not applicable.

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

None

Item 5 - Other Information

(a) None

(b) On October 16, 2007, the Governance and Nominating Committee ("Committee") of the Board of Directors of the Company amended its policy on shareholder recommendations of director nominees to provide that, in order for a director candidate to be considered for nomination at the Company's annual meeting of shareholders, the recommendation must be received by the Committee at least 120 calendar days prior to the date the Company's proxy statement was released to shareholders in connection with the previous year's annual meeting, advanced by one year.

Item 6 - Exhibits

(a) The following documents are filed as a part of this report:

3.1 Articles of Incorporation of Citizens Financial Services, Inc., as amended[(1)]

3.2 Bylaws of Citizens Financial Services, Inc.[(2)]

4 Instrument defining the rights of security holders.[(3)]

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32.1 Section 1350 Certification of Chief Executive Officer

32.2 Section 1350 Certification of Chief Financial Officer

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(1) Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000, as filed with the Commission on May 11, 2000.

(2) Incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, as filed with the Commission on April 29, 2004.

(3) Incorporated by reference to Exhibit 4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the Commission on March 14, 2006.

Signatures

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

	Citizens Financial Services, Inc. **(Registrant)**	
November 8, 2007	By:	/s/ Randall E. Black By: Randall E. Black President and Chief Executive Officer (Principal Executive Officer)
November 8, 2007	By:	/s/ Mickey L. Jones By: Mickey L. Jones Chief Financial Officer (Principal Accounting Officer)