NORWOOD FINANCIAL CORP
Form 10-Q
August 11, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2006

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 0-28366

Norwood Financial Corp.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2828306
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
717 Main Street, Honesdale, Pennsylvania	18431
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (570) 253-1455

N/A
Former name, former address and former fiscal year, if changed since last report.

Indicate by check (x) 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 [x] No [ ]

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

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [x]

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of Exchange Act): Yes [ ] No [x]

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

Class	Outstanding as of August 11, 2006
Common stock, par value $0.10 per share	2,799,897

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FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2006
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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

NORWOOD FINANCIAL CORP.
Consolidated Balance Sheets
(dollars in thousands, except per share data)

	June 30, 2006 (Unaudited)	Decemb 20
ASSETS		
Cash and due from banks	$ 10,509	$ 9

Interest bearing deposits with banks	179	
Federal funds sold	13,615	
Cash and cash equivalents	24,303	9
Securities available for sale	114,441	115
Securities held to maturity, fair value 2006: $971, 2005: $1,480	954	1
Loans receivable (net of unearned income)	299,366	290
Less: Allowance for loan losses	3,794	3
Net loans receivable	295,572	287
Investment in FHLB Stock, at cost	2,294	1
Bank premises and equipment, net	5,457	5
Accrued interest receivable	1,965	1
Other assets	10,173	10
TOTAL ASSETS	$455,159	$433
LIABILITIES		
Deposits:		
Non-interest bearing demand	$ 59,538	$ 50
Interest bearing	293,929	289
Total deposits	353,467	340
Short-term borrowings	13,687	18
Other borrowings	35,000	23
Accrued interest payable	1,760	1
Other liabilities	2,053	1
TOTAL LIABILITIES	405,967	385
STOCKHOLDERS' EQUITY		
Common stock, $.10 par value, authorized 10,000,000 shares, issued 2006: 2,840,872, 2005: 2,705,715	284	
Surplus	9,997	5
Retained earnings	41,249	43
Treasury stock at cost: 2006: 40,975 shares, 2005: 21,189	(1,205)	
Unearned ESOP shares	(27)	
Accumulated other comprehensive loss	(1,106)	
TOTAL STOCKHOLDERS' EQUITY	49,192	48
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$455,159	$433

See accompanying notes to the consolidated financial statements

NORWOOD FINANCIAL CORP.
Consolidated Statements of Income (unaudited)
(dollars in thousands, except per share data)

	Three Months Ended	Six Months Ended
	June 30,	June 30,

	2006	2005	2006	2005
INTEREST INCOME				
Loans receivable, including fees	$ 5,201	$ 4,288	$10,145	$ 8,208
Securities	1,066	1,020	2,116	2,061
Other	83	5	85	17
Total interest income	6,350	5,313	12,346	10,286
INTEREST EXPENSE				
Deposits	1,738	1,102	3,328	2,089
Short-term borrowings	163	112	350	211
Other borrowings	420	303	713	620
Total interest expense	2,321	1,517	4,391	2,920
NET INTEREST INCOME	4,029	3,796	7,955	7,366
PROVISION FOR LOAN LOSSES	55	90	125	190
NET INTEREST INCOME AFTER PROVSION FOR LOAN LOSSES	3,974	3,706	7,830	7,176
OTHER INCOME				
Service charges and fees	644	603	1,234	1,182
Income from fiduciary activities	95	92	172	176
Net realized gains on sales of securities	14	3	21	80
Gain on sale of loans and servicing rights	107	15	107	55
Other	143	152	293	292
Total other income	1,003	865	1,827	1,785
OTHER EXPENSES				
Salaries and employee benefits	1,456	1,334	2,862	2,721
Occupancy, furniture & equipment, net	369	365	749	749
Data processing related	170	153	326	313
Taxes, other than income	111	109	224	207
Professional fees	104	139	217	248
Other	631	577	1,229	1,090
Total other expenses	2,841	2,677	5,607	5,328
INCOME BEFORE INCOME TAXES	2,136	1,894	4,050	3,633
INCOME TAX EXPENSE	660	564	1,241	1,060
NET INCOME	$ 1,476	$ 1,330	$ 2,809	$ 2,573
BASIC EARNINGS PER SHARE	$ 0.53	$ 0.47	$ 1.00	$ 0.92
DILUTED EARNINGS PER SHARE	$ 0.52	$ 0.46	$ 0.98	$ 0.90

See accompanying notes to the consolidated financial statements

NORWOOD FINANCIAL CORP.
Consolidated Statements of Changes in Stockholders' Equity (unaudited)

(dollars in thousands, except per share data)

	Number of Shares Issued	Common Stock	Surplus	Retained Earnings	Treasury Stock	U E S
Balance December 31, 2004	2,705,715	$270	$5,336	$40,222	($149)	
Comprehensive Income:						
Net Income				2,573		
Change in unrealized gains (losses) on securities available for sale, net of reclassification adjustment and tax effects						
Total comprehensive income						
Cash dividends declared, $.34 per share				(958)		
Stock options exercised			(3)		86	
Tax benefit of stock options exercised			13			
Release of treasury stock for ESOP					22	
Acquisition of treasury stock					(408)	
Release of earned ESOP shares			179			
Balance, June 30, 2005	2,705,715	$270	$5,525	$41,837	($449)	

	Number of Shares Issued	Common Stock	Surplus	Retained Earnings	Treasury Stock	U E S
Balance December 31, 2005	2,705,715	$270	$5,648	$43,722	($633)	
Comprehensive Income:						
Net Income			2,809			
Change in unrealized gains (losses) on securities available for sale, net of reclassification adjustment and tax effects						
Total comprehensive income						
Cash dividends declared, $.41 per share				(1,143)		
5% Stock dividend at $30.59 per share	135,157	14	4,121	(4,139)		
Acquisition of treasury stock					(584)	
Stock options exercised					12	
Tax benefit of stock options exercised			(2)			
Stock options issued			34			
Release of earned ESOP shares			196			

Balance, June 30, 2006	2,840,872	$284	$9,997	$41,249	($1,205)
	=========	====	======	=======	=======

See accompanying notes to the consolidated financial statements

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NORWOOD FINANCIAL CORP.
Consolidated Statements of Cash Flows (unaudited)
(dollars in thousands)

	Six Month
	2006
CASH FLOWS FROM OPERATING ACTIVITIES	
Net Income	$ 2,809
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	125
Depreciation	249
Amortization of intangible assets	26
Deferred income taxes	(252)
Net amortization of securities premiums and discounts	173
Net realized gain on sales of securities	(6)
Earnings on life insurance policy	(129)
Net gain on sale of mortgage loans	(107)
Gain on sale of bank premises and equipment and foreclosed real estate	(12)
Mortgage loans originated for sale	(426)
Proceeds from sale of mortgage loans and servicing rights	533
Tax benefit of stock options exercised	(2)
Compensation expense related to stock options	34
Release of ESOP shares	296
(Increase) decrease in accrued interest receivable and other assets	522
Increase in accrued interest payable and other liabilities	677
Net cash provided by operating activities	4,510
CASH FLOWS FROM INVESTING ACTIVITIES	
Securities available for sale:	
Proceeds from sales	30
Proceeds from maturities and principal reductions on mortgage-backed securities	11,622
Purchases	(10,960)
Securities held to maturity- proceeds	505
(Increase) decrease in investment in FHLB stock	(674)
Net increase in loans	(8,541)
Purchase of bank premises and equipment	(313)
Proceeds from sale of bank premises and equipment and foreclosed real estate	12
Net cash used in investing activities	(8,319)
CASH FLOWS FROM FINANCING ACTIVITIES	
Net increase in deposits	12,864
Net decrease in short-term borrowings	(4,877)
Repayments of long-term debt	-
Proceeds from other borrowings	12,000
Stock options exercised	12

Acquisition of treasury stock	(584)
Cash dividends paid	(1,119)
Net cash provided by financing activities	18,296
Increase (decrease) in cash and cash equivalents	14,487
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	9,816
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 24,303

See accompanying notes to the consolidated financial statements

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Norwood Financial Corp. (Company) and its wholly-owned subsidiary, Wayne Bank (Bank) and the Bank's wholly-owned subsidiaries, WCB Realty Corp., Norwood Investment Corp. and WTRO Properties. All significant intercompany transactions have been eliminated in consolidation.

2. ESTIMATES

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In preparing the 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. Actual results could differ from those estimates. The financial statements reflect, in the opinion of management, all normal, recurring adjustments necessary to present fairly the financial position of the Company. The operating results for the three and six month periods ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006 or any other future interim period.

These statements should be read in conjunction with the consolidated financial statements and related notes which are incorporated by reference in the Company's Annual Report on Form 10-K for the year-ended December 31, 2005.

3. EARNINGS PER SHARE

On April 11, 2006, the Company declared a 5% stock dividend on common stock outstanding payable May 26, 2006 to shareholders of record on May 12, 2006. The stock dividend resulted in the issuance of 135,157 additional common shares. All per share data has been adjusted for the effect of the stock dividend.

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

The following table sets forth the computations of basic and diluted earnings per share:

(in thousands)

	Three Months Ended June 30,		Six Months Ende June 30,	
	2006	2005	2006	20
Basic EPS weighted average shares outstanding	2,793	2,805	2,796	2,8
Dilutive effect of stock options	58	60	57	
Diluted EPS weighted average shares outstanding	2,851	2,865	2,853	2,8

4. STOCK-BASED COMPENSATION

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123(R), "Share-Based Payment." Statement No. 123(R) replaces Statement No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." Statement No. 123(R) requires the fair value of share-based payment transactions to be recognized as compensation costs in the financial statements over the period than an employee provides service in exchange for the award. The fair value of the share-based payments is estimated using the Black-Scholes option-pricing model. The Company adopted Statement No. 123(R) effective January 1, 2006, using the modified-prospective transition method. Under the modified prospective method, companies are required to record compensation cost for new and modified awards over the related vesting period of such awards and record compensation cost prospectively for the unvested portion, at the date of adoption, of previously issued and outstanding awards over the remaining vesting period of such awards. No change to prior periods presented is permitted under the modified prospective method. The Company did not issue any stock options in 2005. The Company's shareholders approved the Norwood Financial Corp 2006 Stock Option Plan at the annual meeting on April 25, 2006. As a result, the Company awarded 25,200 options, all of which have a twelve month vesting period. Included in the results for the three and six months ended June 30, 2006 was $34,000 in compensation costs relating to the adoption of Statement No. 123(R). Net income for the three and six months ended June 30, 2006 was reduced by approximately $22,000. As of June 30, 2006, there was approximately $170,000 of total unrecognized compensation cost related to nonvested options under the plan.

The following table illustrates the effect on net income and earnings per share, for the three and six months ended June 30, 2005, if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation" to stock-based compensation:

(in thousands, except for per share data)	Three Months Ended June 30, 2005	Six Months En June 30, 20
Net income as reported	$1,330	$2,573
Total stock-based employee compensation cost, net of tax, which would have been included in the determination of net income if the fair value based method had been applied to all awards	(49)	(98)
Pro forma net income	$1,281	$2,475
Earnings per share (basic)		
As Reported	.47	.92
Pro forma	.46	.88
Diluted earnings per share (assuming dilution)		
As Reported	.46	.90
Pro forma	.45	.86

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	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Term (in years)
Outstanding at the beginning of the year	140,296	$18.45	
Granted..............................	25,200	30.38	
Exercised............................	(413)	23.95	
Forfeited............................	-	-	
Outstanding as of June 30, 2006	165,083	20.26	6.3
Exercisable as of June 30, 2006	139,883	18.43	5.2

The fair value of options granted for the period ended June 30, were estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

Six Months Ended
June 30, 2006

Dividend yield..................................	2.71%
Expected life...................................	7 years
Expected volatility.............................	25.4%
Risk-free interest rate.........................	4.99%
Weighted average fair value of options granted....	$8.12

There were no new options granted for the six months ended June 30, 2005.

5. CASH FLOW INFORMATION

For the purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks and federal funds sold.

Cash payments for interest for the six months ended June 30, 2006 and 2005 were $4,311,000 and $2,971,000 respectively. Cash payments for income taxes in 2006 were $1,244,000 compared to $1,118,000 in 2005. Non-cash investing activities for 2006 and 2005 included foreclosed mortgage loans and repossession of other assets of $65,000 and $67,000, respectively.

6. COMPREHENSIVE INCOME

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

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(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Unrealized holding gains/(losses) on available for sale securities	($287)	$ 791	($486)	($584)
Reclassification adjustment for gains realized in net income	(14)	(3)	(21)	(80)
Net unrealized gains/(losses)	$(301)	788	(507)	(664)
Income tax (benefit)	(103)	267	(173)	(228)
Other comprehensive income (loss)	$(198)	$ 521	$(334)	$(436)

7. OFF-BALANCE SHEET FINANCIAL INSTRUMENTS AND GUARANTEES

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

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

A summary of the Bank's financial instrument commitments is as follows: (in thousands)

	June 30,	
	2006	2005
Commitments to grant loans	$17,328	$11,000
Unfunded commitments under lines of credit	32,547	33,634
Standby letters of credit	7,137	1,679
	$57,012	$46,313

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

The Bank does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Bank, generally, holds collateral and/or personal guarantees supporting these commitments. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required under the corresponding guarantees. The current amount of the liability as of June 30, 2006 for guarantees under standby letters of credit issued is not material.

8. NEW ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued FASB interpretation No. 48, "Accounting for Uncertainty in Income Taxes." The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." Specifically, the pronouncement prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. The interpretation is effective for fiscal years beginning after December 15, 2006. The Company is evaluating the impact of this new pronouncement on its consolidated financial statements.

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

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words believes, anticipates, contemplates, expects, and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, risks associated with the effect of opening a new branch, the ability to control costs and expenses, demand for real estate and general economic conditions. The Company undertakes no obligation to publicly release the results of any revisions to those forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

CRITICAL ACCOUNTING POLICIES

Note 2 to the Company's consolidated financial statements (incorporated by reference in Item 8 of the form 10-K) lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of the Company and its results of operations.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, accounting for stock options, the valuation of deferred tax assets and the determination of other-than-temporary impairment losses on securities. Please refer to the discussion of the allowance for loan losses calculation under "Non-performing Assets and Allowance for Loan Losses" in the "Financial Condition" section. For periods ending prior to January 1, 2006, the Company accounted for stock

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option plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations. No stock-based employee compensation was reflected in net income, as all options granted had an exercise price equal to the market value of the underlying common stock on the grant date. The Company adopted SFAS No. 123(R), "Share-Based

Payment" as of January 1, 2006. However, no stock options were awarded in 2005 or for the three months ended March 31, 2006. The Norwood Financial Corp. 2006 Stock Option Plan was approved on April 25, 2006. The Company granted 25,200 options in the second quarter of 2006. See Note 4 for a discussion of this pronouncement's impact on the Company's consolidated financial statements.

The deferred income taxes reflect temporary differences in the recognition of the revenue and expenses for tax reporting and financial statement purposes, principally because certain items are recognized in different periods for financial reporting and tax return purposes. Although realization is not assured, the Company believes it is more likely than not that all deferred tax assets will be realized.

In estimating other-than-temporary impairment losses on securities, the Company considers 1) the length of time and extent to which the fair value has been less than cost 2) the financial condition of the issuer and 3) the intent and ability of the Company to hold the security to allow for a recovery to fair value.

CHANGES IN FINANCIAL CONDITION

GENERAL

Total assets as of June 30, 2006 were $455.2 million compared to $433.6 million as of December 31, 2005, an increase of $21.6 million, or 5.0%.

SECURITIES

The fair value of securities available for sale as of June 30, 2006 was $114.4 million compared to $115.8 million as of December 31, 2005. The Company purchased $11.0 million of securities to offset $12.1 million of maturities and principal reductions on mortgage-backed securities. The purchases were principally in short-term U.S. Government sponsored agencies and pass-through mortgage-backed securities.

The Company has securities in an unrealized loss position. In Management's opinion, the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. The Company's available-for-sale portfolio has an average repricing term of 1.9 years. Interest rates in the 2-3 year section of the treasury yield curve have increased over 100 basis points in the last year impacting the fair value of individual securities. Management believes that the unrealized losses represent temporary impairment of the securities, as a result of changes in interest rates. The Company has the intent and ability to hold these investments until maturity or market price recovery.

LOANS RECEIVABLE

Loans receivable totaled $299.4 million compared to $290.9 million as of December 31, 2005. Commercial real estate loans decreased $2.7 million due to the pay off of a short-term $6.7 million loan originated in the first quarter of 2005. This was offset by a $5.6 million increase in commercial term loans and lines of credit and $8.6 million growth in residential real estate loans. The growth in residential real estate loans has principally been in fixed rate first lien residential mortgages. The Company does not originate any non-traditional mortgage products such as interest-only loans or option adjustable-rate mortgages, nor offer any terms over 30 years.

Set forth below is selected data relating to the composition of the loan portfolio at the dates indicated:

Types of loans (dollars in thousands)	June 30, 2006 $	June 30, 2006 %	December 31, $
Real Estate-Residential	$109,353	36.5%	$100,705
Commercial	130,799	43.6	133,495
Construction	4,608	1.5	5,944
Commercial, financial and agricultural	32,262	10.8	26,755
Consumer loans to individuals	22,733	7.6	24,353
Total loans	299,755	100.0%	291,252
Deferred fees (net)	(389)		(362)
	299,366		290,890
Allowance for loan losses	(3,794)		(3,669)
Net loans receivable	$295,572		$287,221

ALLOWANCE FOR LOAN LOSSES AND NON-PERFORMING ASSETS

Following is a summary of changes in the allowance for loan losses for the periods indicated:

	Three Months Ended June 30		Six Months Ended June 30	
(dollars in thousands)	2006	2005	2006	2005
Balance, beginning	$ 3,743	$ 3,523	$ 3,669	$ 3,448
Provision for loan losses	55	90	125	190
Charge-offs	(23)	(34)	(50)	(81)
Recoveries	19	21	50	43
Net charge-offs	(4)	(13)	-	(38)
Balance, ending	$ 3,794	$ 3,600	$ 3,794	$ 3,600
Allowance to total loans	1.27%	1.31%	1.27%	1.31%
Net charge-offs to average loans (annualized)	.01%	.02%	.-%	.03%

The allowance for loan losses totaled $3,794,000 as of June 30, 2006 and represented 1.27% of total loans compared to $3,669,000 and 1.26% as of December 31, 2005. Recoveries offset charge-offs for a net charge-off of -0- for the six months ended June 30, 2006 declining from net charge-offs of $38,000 for the similar period in 2005. The decrease was principally due to lower level of repossessed automobiles, as the Company has lowered its exposure to indirect automobile lending. As a result of the lower net charge-offs, the provision for loan losses was less for the six months ended June 30, 2006, $125,000, compared to $190,000 for the similar period in 2005.

The Company assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes an analysis of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and a historical review of credit losses by loan type. Other factors considered include: concentration of credit in specific industries; economic and industry conditions; trends in delinquencies and loan risk-rated classifications, large dollar exposures and loan growth. Management considers the allowance adequate at June 30, 2006 based on the Company's criteria. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any that might be incurred in the future.

As of June 30, 2006, non-performing loans totaled $314,000, which is ..10% of total loans compared to $353,000, or .12% of total loans at December 31, 2005. There was one property in foreclosed real estate, carried at $24,000 which is actively being marketed. The following table sets forth information regarding non-performing loans and foreclosed real estate at the date indicated:

	June 30, 2006	December 31, 2005
(dollars in thousands)		
Loans accounted for on a non accrual basis:		
Commercial and all other	$ -	$ -
Real Estate	303	330
Consumer	11	11
Total	314	341
Accruing loans which are contractually past due 90 days or more	-	12
Total non-performing loans	314	353
Foreclosed real estate	24	-
Total non-performing assets	$338	$353
Allowance for loan losses coverage of non-performing loans	12.1x	10.4x
Non-performing loans to total loans	.10%	.12%
Non-performing assets to total assets	.07%	.08%

DEPOSITS

Total deposits as of June 30, 2006 were $353.5 million increasing from $340.6 million as of December 31, 2005. The increase in non-interest bearing and interest bearing demand deposits is due in part to new commercial accounts and the seasonality of certain corporate and municipal accounts. Time deposits greater than $100,000 decreased $18.2 million because of an $8 million short-term time deposit moved to a money market account and the scheduled maturity of short-term time deposits from local school districts. Time deposits less than $100,000 increased principally due to promotional efforts in certain products.

The following table sets forth deposit balances as of the dates indicated.

(dollars in thousands)	June 30, 2006	December 31, 2005
Non-interest bearing demand	$ 59,538	$ 50,891
Interest bearing demand	43,976	40,738
Money Market	63,959	52,194
Savings	51,005	53,311
Time deposits		