PENNS WOODS BANCORP INC
Form 10-K
March 12, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2009

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

Commission file number 0-17077

PENNS WOODS BANCORP, INC.

Pennsylvania	**23-2226454**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

300 Market Street, P.O. Box 967
Williamsport, Pennsylvania **17703-0967**

Registrant s telephone number, including area code **(570) 322-1111**

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

Title of each class	Name of each exchange which registered
Common Stock, par value $8.33 per share	**The NASDAQ Stock Market LLC**

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

None

(Title of Class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o

(Do not check if a smaller reporting company)

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

State the aggregate market value of the voting stock held by non-affiliates of the registrant **$111,692,367 at June 30, 2009.**

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

Class	Outstanding at March 2, 2010
Common Stock, $8.33 Par Value	**3,834,475 Shares**

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement prepared in connection with its annual meeting of shareholders to be held on April 28, 2010 are incorporated by reference in Part III hereof.

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PART I

ITEM 1 BUSINESS

A. General Development of Business and History

On January 7, 1983, Penns Woods Bancorp, Inc. (the Company) was incorporated under the laws of the Commonwealth of Pennsylvania as a bank holding company. The Jersey Shore State Bank, a Pennsylvania state-charted bank, (the Bank) became a wholly owned subsidiary of the Company, and each outstanding share of Bank common stock was converted into one share of Company common stock. This transaction was approved by the shareholders of the Bank on April 11, 1983 and was effective on July 12, 1983. The Company s two other wholly-owned subsidiaries are Woods Real Estate Development Company, Inc. and Woods Investment Company, Inc. The Company s business has consisted primarily of managing and supervising the Bank, and its principal source of income has been dividends paid by the Bank and Woods Investment Company, Inc.

The Bank is engaged in commercial and retail banking which includes the acceptance of time, savings, and demand deposits, the funding of commercial, consumer, and mortgage loans, and safe deposit services. Utilizing a thirteen branch office network, ATMs, internet, and telephone banking delivery channels, the Bank delivers its products and services to the communities it resides in.

In October 2000, the Bank acquired The M Group, Inc. D/B/A The Comprehensive Financial Group (The M Group). The M Group, which operates as a subsidiary of the Bank, offers insurance and securities brokerage services. Securities are offered by The M Group through ING Financial Partners, Inc., a registered broker-dealer.

Neither the Company nor the Bank anticipates that compliance with environmental laws and regulations will have any material effect on capital expenditures, earnings, or on its competitive position. The Bank is not dependent on a single customer or a few customers, the loss of whom would have a material effect on the business of the Bank.

The Bank employed 192 persons as of December 31, 2009 in either a full-time or part-time capacity. The Company does not have any employees. The principal officers of the Bank also serve as officers of the Company.

Woods Investment Company, Inc., a Delaware holding company, maintains an investment portfolio that is managed for total return and to fund dividend payments to the Company.

Woods Real Estate Development Company, Inc. serves the Company through its acquisition and ownership of certain properties utilized by the Bank.

B. Regulation and Supervision

The Company is also subject to the provisions of the Bank Holding Company Act of 1956, as amended (the BHCA) and to supervision and examination by the Board of Governors of the Federal Reserve System (the FRB). The Bank is subject to the supervision and examination by the Federal Deposit Insurance Corporation (the FDIC), as its primary federal regulator and as the insurer of the Bank s deposits. The Bank is also regulated and examined by the Pennsylvania Department of Banking (the Department).

The insurance activities of The M Group are subject to regulation by the insurance departments of the various states in which The M Group, conducts business including principally the Pennsylvania Department of Insurance. The securities brokerage activities of The M Group are subject to regulation by federal and state securities commissions.

The FRB has issued regulations under the BHCA that require a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. As a result, the FRB, pursuant to such regulations, may require the Company to stand ready to use its resources to provide adequate capital funds to the Bank during periods of financial stress or adversity. The BHCA requires the Company to secure the prior approval of the FRB before it can acquire all or substantially all of the assets of any bank, or acquire ownership or control of 5% or more of any voting shares of any bank. Such a transaction would also require approval of the Department.

A bank holding company is prohibited under the BHCA from engaging in, or acquiring direct or indirect control of, more than 5% of the voting shares of any company engaged in non-banking activities unless the FRB, by order or regulation, has found such activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Under the BHCA, the FRB has the authority to require a bank holding company to terminate any activity or relinquish

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control of a non-bank subsidiary (other than a non-bank subsidiary of a bank) upon the FRB s determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

Bank holding companies are required to comply with the FRB s risk-based capital guidelines. The risk-based capital rules are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and to minimize disincentives for holding liquid assets. Currently, the required minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least half of the total capital is required to be Tier 1 capital, consisting principally of common shareholders equity, less certain intangible assets. The remainder (Tier 2 capital) may consist of certain preferred stock, a limited amount of subordinated debt, certain hybrid capital instruments and other debt securities, 45% of net unrealized gains on marketable equity securities, and a limited amount of the general loan loss allowance. The risk-based capital guidelines are required to take adequate account of interest rate risk, concentration of credit risk, and risks of nontraditional activities.

In addition to the risk-based capital guidelines, the FRB requires each bank holding company to comply with the leverage ratio, under which the bank holding company must maintain a minimum level of Tier 1 capital to average total consolidated assets of 3% for those bank holding companies which have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are expected to maintain a leverage ratio of at least 4% to 5%. The Bank is subject to similar capital requirements adopted by the FDIC.

Dividends

Federal and state laws impose limitations on the payment of dividends by the Bank. The Pennsylvania Banking Code restricts the availability of capital funds for payment of dividends by the Bank to its additional paid-in capital.

In addition to the dividend restrictions described above, the banking regulators have the authority to prohibit or to limit the payment of dividends by the Bank if, in the banking regulator s opinion, payment of a dividend would constitute an unsafe or unsound practice in light of the financial condition of the Bank.

Under Pennsylvania law, the Company may not pay a dividend, if, after giving effect thereto, it would be unable to pay its debts as they become due in the usual course of business and, after giving effect to the dividend, the total assets of the Company would be less than the sum of its total liabilities plus the amount that would be needed, if the Company were to be dissolved at the time of distribution, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to those receiving the dividend.

It is also the policy of the FRB that a bank holding company generally only pay dividends on common stock out of net income available to common shareholders over the past year and only if the prospective rate of earnings retention appears consistent with a bank holding company s capital needs, asset quality, and overall financial condition. In the current financial and economic environment, the FRB has indicated that bank holding companies should carefully review their dividend policy and has discouraged dividend pay-out ratios at the 100% level unless both asset quality and capital are very strong. A bank holding company also should not maintain a dividend level that places undue pressure on the capital of such institution s subsidiaries, or that may undermine the bank holding company s ability to serve as a source of strength for such subsidiaries.

C. Regulation of the Bank

From time to time, various types of federal and state legislation have been proposed that could result in additional regulation of, and restrictions of, the business of the Bank. It cannot be predicted whether any such legislation will be adopted or how such legislation would affect business of the Bank. As a consequence of the extensive regulation of commercial banking activities in the United States, the Bank s business is particularly susceptible to being affected by federal legislation and regulations that may increase the costs of doing business.

Prompt Corrective Action

The FDIC has specified the levels at which an insured institution will be considered well-capitalized, adequately capitalized, undercapitalized, and critically undercapitalized. In the event an institution s capital deteriorates to the undercapitalized category or below, the Federal Deposit Insurance Act (the FDIA) and FDIC regulations prescribe an increasing amount of regulatory intervention, including: (1) the institution of a capital restoration plan by a bank and a guarantee of the plan by a parent institution and liability for civil money damages for failure to fulfill its commitment on

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that guarantee; and (2) the placement of a hold on increases in assets, number of branches, or lines of business. If capital has reached the significantly or critically undercapitalized levels, further material restrictions can be imposed, including restrictions on interest payable on accounts, dismissal of management and (in critically undercapitalized situations) appointment of a receiver. For well-capitalized institutions, the FDIA provides authority for regulatory intervention where the institution is deemed to be engaging in unsafe or unsound practices or receives a less than satisfactory examination report rating for asset quality, management, earnings or liquidity.

Deposit Insurance

The FDIC maintains the Deposit Insurance Fund (DIF) by assessing depository institutions an insurance premium. The amount each institution is assessed is based upon a variety of factors that include the balance of insured deposits as well as the degree of risk the institution poses to the insurance fund. As a result of the enactment of the Emergency Economic Stabilization Act of 2008, the FDIC increased the amount of deposits it insures from $100,000 to $250,000. This increase is temporary and will continue through December 31, 2013. The Bank pays an insurance premium into the DIF based on the quarterly average daily deposit liabilities net of certain exclusions. The FDIC uses a risk-based premium system that assesses higher rates on those institutions that pose greater risks to the DIF. The FDIC places each institution in one of four risk categories using a two-step process based first on capital ratios (the capital group assignment) and then on other relevant information (the supervisory group assignment). Subsequently, the rate for each institution within a risk category may be adjusted depending upon different factors that either enhance or reduce the risk the institution poses to the DIF, including the unsecured debt, secured liabilities and brokered deposits related to each institution. Finally, certain risk multipliers may be applied to the adjusted assessment. In 2009, the FDIC increased the amount assessed from financial institutions by increasing its risk-based deposit insurance assessment scale. The quarterly annualized assessment scale for 2009 ranged from twelve basis points of assessable deposits for the strongest institutions to over fifty basis points for the weakest. In 2009, the FDIC also adopted a uniform special assessment rate for all institutions not to exceed 10 basis points on the individual bank s assessment base.

On November 12, 2009, the FDIC approved a rule to require insured institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012. An insured institution s risk-based deposit insurance assessments will continue to be calculated on a quarterly basis, but will be paid from the amount the institution prepaid until the later of the date that amount is exhausted or June 30, 2013, at which point any remaining funds would be returned to the insured institution. Consequently, the Company s prepayment of DIF premiums made in December 2009 resulted in a prepaid asset of $2,366,000.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank of Pittsburgh (the FHLB), which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the Federal Home Loan Bank. At December 31, 2009, the Bank had $91,933,000 in FHLB advances.

As a member, the Bank is required to purchase and maintain stock in the FHLB in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of its outstanding advances from the FHLB. At December 31, 2009, the Bank had $7,271,000 million in stock of the FHLB which was in compliance with this requirement.

Other Legislation

The Fair and Accurate Credit Transactions Act (FACT) was signed into law on December 4, 2003. This law extends the previously existing Fair Credit Reporting Act. New provisions added by FACT address the growing problem of identity theft. Consumers will be able to initiate a fraud alert when they are victims of identity theft, and credit reporting agencies will have additional duties. Consumers will also be entitled to obtain free credit reports through the credit beaures, and will be granted certain additional privacy rights.

The Sarbanes-Oxley Act of 2002 was enacted to enhance penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures under the federal securities laws. The Sarbanes-Oxley Act generally applies to all companies, including the Company, that file or are required to file periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934, or the Exchange Act. The legislation includes provisions, among other things, governing the services that can be provided by a public company s independent auditors and the procedures for approving such services, requiring the chief executive

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officer and principal accounting officer to certify certain matters relating to the company s periodic filings under the Exchange Act, requiring expedited filings of reports by insiders of their securities transactions and containing other provisions relating to insider conflicts of interest, increasing disclosure requirements relating to critical financial accounting policies and their application, increasing penalties for securities law violations, and creating a new public accounting oversight board, a regulatory body subject to SEC jurisdiction with broad powers to set auditing, quality control, and ethics standards for accounting firms. In response to the legislation, the national securities exchanges and NASDAQ have adopted new rules relating to certain matters, including the independence of members of a company s audit committee as a condition to listing or continued listing.

Congress is currently debating major legislation that may fundamentally change the regulatory oversight of banking institutions in the United States. Whether any legislation will be enacted or additional regulations will be adopted, and how they might impact the Company cannot be determined at this time.

In addition to federal banking law, the Bank is subject to the Pennsylvania Banking Code. The Banking Code was amended in late 2000 to provide more complete parity in the powers of state-chartered institutions compared to national banks and federal savings banks doing business in Pennsylvania. Pennsylvania banks have the same ability to form financial subsidiaries authorized by the Gramm-Leach-Bliley Act, as do national banks.

Environmental Laws

Environmentally related hazards have become a source of high risk and potential liability for financial institutions relating to their loans. Environmentally contaminated properties owned by an institution s borrowers may result in a drastic reduction in the value of the collateral securing the institution s loans to such borrowers, high environmental clean up costs to the borrower affecting its ability to repay the loans, the subordination of any lien in favor of the institution to a state or federal lien securing clean up costs, and liability to the institution for clean up costs if it forecloses on the contaminated property or becomes involved in the management of the borrower. The Company is not aware of any borrower who is currently subject to any environmental investigation or clean up proceeding which is likely to have a material adverse effect on the financial condition or results of operations of the Company.

Effect of Government Monetary Policies

The earnings of the Company are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States Government and its agencies. The monetary policies of the FRB have had, and will likely continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The FRB has a major effect upon the levels of bank loans, investments, and deposits through its open market operations in the United States Government securities and through its regulation of, among other things, the discount rate on borrowing of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature and impact of future changes in monetary and fiscal policies.

DESCRIPTION OF BANK

History and Business

Jersey Shore State Bank (Bank) was incorporated under the laws of the Commonwealth of Pennsylvania as a state bank in 1934 and became a wholly owned subsidiary of the Company on July 12, 1983.

As of December 31, 2009, the Bank had total assets of $667,933,000; total shareholders equity of $55,117,000 and total deposits of $500,100,000. The Bank s deposits are insured by the Federal Deposit Insurance Corporation for the maximum amount provided under current law.

The Bank engages in business as a commercial bank, doing business at several locations in Lycoming, Clinton, and Centre Counties, Pennsylvania. The Bank offers insurance, securities brokerage services, annuity and mutual fund investment products, and financial planning through its wholly owned subsidiary, The M Group, Inc. D/B/A The Comprehensive Financial Group.

Services offered by the Bank include accepting time, demand and savings deposits including Super NOW accounts, statement savings accounts, money market accounts, fixed rate certificates of deposit, and club accounts. Its services also include making secured and unsecured business and consumer loans that include financing commercial transactions as well as construction and residential mortgage loans and revolving credit loans with overdraft protection.

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The Bank s loan portfolio mix can be classified into four principal categories. These are real estate, agricultural, commercial, and consumer. Real estate loans can be further segmented into construction and land development, farmland, one-to-four family residential, multi-family, and commercial or industrial. Qualified borrowers are defined by policy and our underwriting standards. Owner provided equity requirements range from 20% to 30% with a first lien status required. Terms are generally restricted to between 10 and 20 years with the exception of construction and land development, which are limited to one to five years. Real estate appraisals, property construction verifications, and site visitations comply with policy and industry regulatory standards.

Prospective residential mortgage customer s repayment ability is determined from information contained in the application and recent income tax returns. Emphasis is on credit, employment, income, and residency verification. Broad hazard insurance is always required and flood insurance where applicable. In the case of construction mortgages, builders risk insurance is requested.

Agricultural loans for the purchase or improvement of real estate must meet the Bank s real estate underwriting criteria. The only permissible exception is when a Farmers Home Loan Administration guaranty is obtained. Agricultural loans made for the purchase of equipment are usually payable in five years, but never more than seven, depending upon the useful life of the purchased asset. Minimum borrower equity ranges from 20% to 30%. Livestock financing criteria depends upon the nature of the operation. Agricultural loans are also made for crop production purposes. Such loans are structured to repay within the production cycle and not carried over into a subsequent year.

Commercial loans are made for the acquisition and improvement of real estate, purchase of equipment, and for working capital purposes on a seasonal or revolving basis. General purpose working capital loans are also available with repayment expected within one year. Equipment loans are generally amortized over three to seven years, with an owner equity contribution required of at least 20% of the purchase price. Insurance coverage with the Bank as loss payee is required, especially in the case where the equipment is rolling stock. It is also a general policy to collateralize non-real estate loans with the asset purchased and, dependant upon loan terms, junior liens are filed on other available assets. Financial information required on all commercial mortgages includes the most current three years balance sheets and income statements and projections on income to be developed through the project. In the case of corporations and partnerships, the principals are often asked to personally guaranty the entity s debt.

Seasonal and revolving lines of credit are offered for working capital purposes. Collateral for such a loan includes the pledge of inventory and/or receivables. Drawing availability is usually 50% of inventory and 75% of eligible receivables. Eligible receivables are defined as invoices less than 90 days delinquent. Exclusive reliance is very seldom placed on such collateral; therefore, other lienable assets are also taken into the collateral pool. Where reliance is placed on inventory and accounts receivable, the applicant must provide financial information including agings on a monthly basis. In addition, the guaranty of the principals is usually obtained.

Letter of Credit availability is limited to standbys where the customer is well known to the Bank. Credit criteria is the same as that utilized in making a direct loan. Collateral is obtained in most cases, and whenever the expiration date is beyond one year.

Consumer loan products include second mortgages, automobile financing, small loan requests, overdraft check lines, and PHEAA referral loans. Our policy includes standards used in the industry on debt service ratios and terms are consistent with prudent underwriting standards and the use of proceeds. Verifications are made of employment and residency, along with credit history.

Second mortgages are confined to equity borrowing and home improvements. Terms are generally ten years or less and rates are fixed. Loan to collateral value criteria is 80% or less and verifications are made to determine values. Automobile financing is generally restricted to five years and done on a direct basis. The Bank, as a practice, does not floor plan and therefore does not discount dealer paper. Small loan requests are to accommodate personal needs such as the purchase of small appliances or for the payment of taxes. Overdraft check lines are limited to $5,000 or less.

The Bank s investment portfolio is analyzed and priced on a monthly basis. Investments are made in U.S. Treasuries, U.S. Agency issues, bank qualified municipal bonds, corporate bonds, and corporate stocks which consist of Pennsylvania bank stocks. Bonds with BAA or better ratings are used, unless a local issue is purchased that has a lesser or no rating. Factors

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taken into consideration when investments are purchased include liquidity, the Company s tax position, tax equivalent yield, third party investment ratings, and the policies of the Asset/Liability Committee.

The banking environment in Lycoming, Clinton, and Centre Counties, Pennsylvania is highly competitive. The Bank operates thirteen full service offices in these markets and competes for loans and deposits with numerous commercial banks, savings and loan associations, and other financial institutions. The economic base of the region is developed around small business, health care, educational facilities (college and public schools), light manufacturing industries, and agriculture.

The Bank has a relatively stable deposit base and no material amount of deposits is obtained from a single depositor or group of depositors, excluding public entities that account for approximately 10% of total deposits. Although the Bank has regular opportunities to bid on pools of funds of $100,000 or more in the hands of municipalities, hospitals, and others, it does not rely on these monies to fund loans or intermediate or longer-term investments.

The Bank has not experienced any significant seasonal fluctuations in the amount of its deposits.

Supervision and Regulation

The earnings of the Bank are affected by the policies of regulatory authorities including the FDIC and the FRB. An important function of the FRB is to regulate the money supply and interest rates. Among the instruments used to implement these objectives are open market operations in U.S. Government Securities, changes in reserve requirements against member bank deposits, and limitations on interest rates that member banks may pay on time and savings deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, investments on deposits, and their use may also affect interest rates charged on loans or paid for deposits.

The policies and regulations of the FRB have had and will probably continue to have a significant effect on the Bank s deposits, loans and investment growth, as well as the rate of interest earned and paid, and are expected to affect the Bank s operation in the future. The effect of such policies and regulations upon the future business and earnings of the Bank cannot accurately be predicted.

ITEM 1A RISK FACTORS

The following sets forth several risk factors that are unique to the Company.

Changes in interest rates could reduce our income, cash flows and asset values.

Our income and cash flows and the value of our assets depend to a great extent on the difference between the interest rates we earn on interest-earning assets, such as loans and investment securities, and the interest rates we pay on interest-bearing liabilities such as deposits and borrowings. These rates are highly sensitive to many factors which are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, will influence not only the interest we receive on our loans and investment securities and the amount of interest we pay on deposits and borrowings but will also affect our ability to originate loans and obtain deposits and the value of our investment portfolio. If the rate of interest we pay on our deposits and other borrowings increases more than the rate of interest we earn on our loans and other investments, our net interest income, and therefore our earnings, could be adversely affected. Our earnings also could be adversely affected if the rates on our loans and other investments fall more quickly than those on our deposits and other borrowings.

Economic conditions either nationally or locally in areas in which our operations are concentrated may adversely affect our business.

Deterioration in local, regional, national or global economic conditions could cause us to experience a reduction in deposits and new loans, an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, all of which could adversely affect our performance and financial condition. Unlike larger banks that are more geographically diversified, we provide banking and financial services locally. Therefore, we are particularly vulnerable to adverse local economic conditions.

Our financial condition and results of operations would be adversely affected if our allowance for loan losses is not sufficient to absorb actual losses or if we are required to increase our allowance.

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Despite our underwriting criteria, we may experience loan delinquencies and losses. In order to absorb losses associated with nonperforming loans, we maintain an allowance for loan losses based on, among other things, historical experience, an evaluation of economic conditions, and regular reviews of delinquencies and loan portfolio quality. Determination of the allowance inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. At any time there are likely to be loans in our portfolio that will result in losses but that have not been identified as nonperforming or potential problem credits. We cannot be sure that we will be able to identify deteriorating credits before they become nonperforming assets or that we will be able to limit losses on those loans that are identified. We may be required to increase our allowance for loan losses for any of several reasons. Federal regulators, in reviewing our loan portfolio as part of a regulatory examination, may request that we increase our allowance for loan losses. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in our allowance. In addition, if charge-offs in future periods exceed our allowance for loan losses, we will need additional increases in our allowance for loan losses. Any increases in our allowance for loan losses will result in a decrease in our net income and, possibly, our capital, and may materially affect our results of operations in the period in which the allowance is increased.

Many of our loans are secured, in whole or in part, with real estate collateral which is subject to declines in value.

In addition to considering the financial strength and cash flow characteristics of a borrower, we often secure our loans with real estate collateral. Real estate values and the real estate market are generally affected by, among other things, changes in local, regional or national economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies, and acts of nature. The real estate collateral provides an alternate source of repayment in the event of default by the borrower. If real estate prices in our markets decline, the value of the real estate collateral securing our loans could be reduced. If we are required to liquidate real estate collateral securing loans during a period of reduced real estate values to satisfy the debt, our earnings and capital could be adversely affected.

Competition may decrease our growth or profits.

We face substantial competition in all phases of our operations from a variety of different competitors, including commercial banks, savings and loan associations, mutual savings banks, credit unions, consumer finance companies, factoring companies, leasing companies, insurance companies, and money market mutual funds. There is very strong competition among financial services providers in our principal service area. Our competitors may have greater resources, higher lending limits, or larger branch systems than we do. Accordingly, they may be able to offer a broader range of products and services as well as better pricing for those products and services than we can.

In addition, some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on federally insured financial institutions. As a result, those nonbank competitors may be able to access funding and provide various services more easily or at less cost than we can, adversely affecting our ability to compete effectively.

The value of certain investment securities is volatile and future declines or other-than-temporary impairments could materially adversely affect our future earnings and regulatory capital.

Continued volatility in the market value for certain of our investment securities, whether caused by changes in market perceptions of credit risk, as reflected in the expected market yield of the security, or actual defaults in the portfolio could result in significant fluctuations in the value of the securities. This could have a material adverse impact on our accumulated other comprehensive loss and shareholders equity depending on the direction of the fluctuations. Furthermore, future downgrades or defaults in these securities could result in future classifications of investment securities as other than temporarily impaired. This could have a material impact on our future earnings, although the impact on shareholders equity will be offset by any amount already included in other comprehensive income for securities where we have recorded temporary impairment.

We may be adversely affected by government regulation.

The banking industry is heavily regulated. Banking regulations are primarily intended to protect the federal deposit insurance funds and depositors, not shareholders. Changes in the laws, regulations, and regulatory practices affecting the banking industry may increase our costs of doing business or otherwise adversely affect us and create competitive advantages for others. Regulations affecting banks and financial services companies undergo continuous change, and we

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cannot predict the ultimate effect of these changes, which could have a material adverse effect on our profitability or financial condition.

We rely on our management and other key personnel, and the loss of any of them may adversely affect our operations.

We are and will continue to be dependent upon the services of our executive management team. In addition, we will continue to depend on our ability to retain and recruit key commercial loan officers. The unexpected loss of services of any key management personnel or commercial loan officers could have an adverse effect on our business and financial condition because of their skills, knowledge of our market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel.

Environmental liability associated with lending activities could result in losses.

In the course of our business, we may foreclose on and take title to properties securing our loans. If hazardous substances were discovered on any of these properties, we could be liable to governmental entities or third parties for the costs of remediation of the hazard, as well as for personal injury and property damage. Many environmental laws can impose liability regardless of whether we knew of, or were responsible for, the contamination. In addition, if we arrange for the disposal of hazardous or toxic substances at another site, we may be liable for the costs of cleaning up and removing those substances from the site even if we neither own nor operate the disposal site. Environmental laws may require us to incur substantial expenses and may materially limit use of properties we acquire through foreclosure, reduce their value or limit our ability to sell them in the event of a default on the loans they secure. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability.

Failure to implement new technologies in our operations may adversely affect our growth or profits.

The market for financial services, including banking services and consumer finance services is increasingly affected by advances in technology, including developments in telecommunications, data processing, computers, automation, Internet-based banking, and telebanking. Our ability to compete successfully in our markets may depend on the extent to which we are able to exploit such technological changes. However, we can provide no assurance that we will be able to properly or timely anticipate or implement such technologies or properly train our staff to use such technologies. Any failure to adapt to new technologies could adversely affect our business, financial condition or operating results.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the Federal Deposit Insurance Corporation, commonly referred to as the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is subject to the same market forces that affect the price of common stock in any company.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

The Company owns and leases its properties. Listed herewith are the locations of properties owned or leased as of December 31, 2009, in which the banking offices are located; all properties are in good condition and adequate for the Bank s purposes:

Office		Address		Ownership
Main		115 South Main Street		Owned
		P.O. Box 5098		
		Jersey Shore, Pennsylvania 17740		
Bridge Street		112 Bridge Street		Owned
		Jersey Shore, Pennsylvania 17740		
DuBoistown		2675 Euclid Avenue		Owned
		Williamsport, Pennsylvania 17702		
Williamsport		300 Market Street		Owned

	P.O. Box 967 Williamsport, Pennsylvania 17703-0967	
Montgomery	9094 Rt. 405 Highway Montgomery, Pennsylvania 17752	Owned
Lock Haven	4 West Main Street Lock Haven, Pennsylvania 17745	Owned
Mill Hall	(Inside Wal-Mart), 173 Hogan Boulevard Mill Hall, Pennsylvania 17751	Under Lease
Spring Mills	3635 Penns Valley Road, P.O. Box 66 Spring Mills, Pennsylvania 16875	Owned
Centre Hall	2842 Earlystown Road Centre Hall, Pennsylvania 16828	Land Under Lease
Zion	100 Cobblestone Road Bellefonte, Pennsylvania 16823	Under Lease
State College	2050 North Atherton Street State College, Pennsylvania 16803	Land Under Lease
Montoursville	820 Broad Street Montoursville, Pennsylvania 17754	Under Lease
The M Group, Inc. D/B/A The Comprehensive Financial Group	705 Washington Boulevard Williamsport, Pennsylvania 17701	Under Lease

ITEM 3 LEGAL PROCEEDINGS

The Company is subject to lawsuits and claims arising out of its business. In the opinion of management, after review and consultation with counsel, any proceedings that may be assessed will not have a material adverse effect on the consolidated financial position of the Company.

ITEM 4 (REMOVED AND RESERVED)

PART II

ITEM 5 MARKET FOR THE REGISTRANT S COMMON STOCK, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

The Common Stock is listed on the NASDAQ Global Select Market under the symbol PWOD . The following table sets forth (1) the quarterly high and low close prices for a share of the Company s Common Stock during the periods indicated, and (2) quarterly dividends on a share of the Common Stock with respect to each quarter since January 1, 2006. The following quotations represent prices between buyers and sellers and do not include retail markup, markdown or commission. They may not necessarily represent actual transactions.

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	High		Low		Dividends Declared
2007					
First quarter	$	37.75	$	35.00	$ 0.44
Second quarter		35.00		33.86	0.44
Third quarter		35.00		30.80	0.45
Fourth quarter		32.50		30.33	0.46
2008					
First quarter	$	33.47	$	29.66	$ 0.46
Second quarter		33.15		33.01	0.46
Third quarter		35.00		29.00	0.46
Fourth quarter		30.40		23.00	0.46
2009					
First quarter	$	25.61	$	23.00	$ 0.46
Second quarter		31.81		24.89	0.46
Third quarter		34.25		29.89	0.46
Fourth quarter		33.24		30.37	0.46

The Bank has paid cash dividends since 1941. The Company has paid dividends since the effective date of its formation as a bank holding company. It is the present intention of the Registrant s Board of Directors to continue the dividend payment policy; however, further dividends must necessarily depend upon earnings, financial condition, appropriate legal restrictions, and other factors relevant at the time the Board of Directors of the Company considers dividend policy. Cash available for dividend distributions to shareholders of the Company primarily comes from dividends paid by the Bank to the Company. Therefore, the restrictions on the Bank s dividend payments are directly applicable to the Company. See also the information appearing in Note 19 to Notes to Consolidated Financial Statements included in the Annual Report on Form 10-K for additional information related to dividend restrictions.

Under the Pennsylvania Business Corporation Law of 1988 a corporation may not pay a dividend, if after giving effect thereto, the corporation would be unable to pay its debts as they become due in the usual course of business and after giving effect thereto the total assets of the corporation would be less than the sum of its total liabilities plus the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of the shareholders whose preferential rights are superior to those receiving the dividend.

As of March 2, 2010, the Company had approximately 1,270 shareholders of record.

Following is a schedule of the shares of the Company s common stock purchased by the Company during the fourth quarter of 2009.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Units) Purchased	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1 (October 1 - October 31, 2009)				78,344
Month #2 (November 1 -				

November 30, 2009)	78,344
Month #3 (December 1 - December 31, 2009)	78,344

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Set forth below is a line graph comparing the yearly dollar changes in the cumulative shareholder return on the Company s common stock against the cumulative total return of the S&P 500 Stock Index, NASDAQ Bank Index, and NASDAQ Composite for the period of five fiscal years assuming the investment of $100.00 on December 31, 2004 and assuming the reinvestment of dividends. The shareholder return shown on the graph below is not necessarily indicative of future performance.

	Period Ending					
Index	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**	**12/31/08**	**12/31/09**
Penns Woods Bancorp, Inc.	100.00	100.79	102.55	93.06	70.13	105.20
S&P 500	100.00	104.91	121.48	128.16	80.74	102.11
NASDAQ Composite	100.00	101.37	111.03	121.92	72.49	104.31
NASDAQ Bank Index	100.00	95.67	106.20	82.76	62.96	51.31

ITEM 6 SELECTED FINANCIAL DATA

The following table sets forth certain financial data as of and for each of the years in the five-year period ended December 31, 2009.

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(In Thousands, Except Per Share Amounts)	2009	2008	2007	2006	2005
Consolidated Statement of Income Data:					
Interest income	$ 36,191	$ 36,108	$ 35,949	$ 33,753	$ 30,903
Interest expense	12,398	14,832	16,447	14,210	10,381
Net interest income	23,793	21,276	19,502	19,543	20,522
Provision for loan losses	917	375	150	635	720
Net interest income after provision for loan losses	22,876	20,901	19,352	18,908	19,802
Noninterest income	2,287	5,456	7,478	9,029	9,431
Noninterest expense	19,812	17,949	17,316	16,329	15,108
Income before income taxes	5,351	8,408	9,514	11,608	14,125
Applicable income taxes	(742)	405	637	1,961	3,224
Net Income	$ 6,093	$ 8,003	$ 8,877	$ 9,647	$ 10,901
Consolidated Balance Sheet at End of Period:					
Total assets	$ 676,204	$ 652,803	$ 628,138	$ 592,285	$ 568,668
Loans	405,529	381,478	360,478	360,384	338,438
Allowance for loan losses	(4,657)	(4,356)	(4,130)	(4,185)	(3,679)
Deposits	497,287	421,368	389,022	395,191	352,529
Long-term debt	86,778	86,778	106,378	82,878	84,478
Shareholders equity	66,916	61,027	70,559	74,594	73,919
Per Share Data:					
Earnings per share - Basic	$ 1.59	$ 2.07	$ 2.28	$ 2.45	$ 2.75
Earnings per share - Diluted	1.59	2.07	2.28	2.45	2.74
Cash dividends declared	1.84	1.84	1.79	1.73	1.56
Book value	17.45	15.93	18.21	19.12	18.59
Number of shares outstanding, at end of period	3,834,114	3,831,500	3,875,632	3,900,742	3,975,787
Average number of shares outstanding-basic	3,832,789	3,859,724	3,886,277	3,934,138	3,971,926
Selected financial ratios:					
Return on average shareholders equity	9.66%	12.02%	12.14%	12.93%	14.54%
Return on average total assets	0.92%	1.27%	1.49%	1.67%	1.97%
Net interest income to average interest earning assets	4.40%	4.14%	3.95%	4.06%	4.29%
Dividend payout ratio	115.74%	88.67%	78.33%	70.51%	57.10%
Average shareholders equity to average total assets	9.50%	10.53%	12.23%	12.92%	13.56%
Loans to deposits, at end of period	81.55%	90.53%	92.66%	91.19%	96.00%

Per share data and number of shares outstanding have been adjusted to give retroactive effect to a six for five stock split issued November 18, 2005.

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ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

RESULTS OF OPERATIONS

NET INTEREST INCOME

Net interest income is determined by calculating the difference between the yields earned on interest-earning assets and the rates paid on interest-bearing liabilities. To compare the tax-exempt asset yields to taxable yields, amounts are adjusted to taxable equivalents based on the marginal corporate federal tax rate of 34%. The tax equivalent adjustments to net interest income for 2009, 2008, and 2007 were $2,952,000, $2,714,000, and $2,410,000, respectively.

2009 vs 2008

Reported net interest income increased $2,517,000 or 11.83% to $23,793,000 for the year ended December 31, 2009 compared to the year ended December 31, 2008, although the yield on earning assets decreased to 6.43% from 6.68%, respectively. On a tax equivalent basis, the change in net interest income was an increase of $2,755,000 or 11.48% to $26,745,000 for the year ended December 31, 2009 compared to the year ended December 31, 2008. Total interest income increased $83,000 due to growth in the average balance of the loan portfolio offset by a decrease in investment portfolio income resulting from decreased dividends. The increase in earning asset volume compensated for the negative impact on earning asset yields caused by the prolonged low interest rate cycle enacted by the Federal Open Markets Committee (FOMC). Interest income recognized on the loan portfolio increased $340,000 as a portion of the portfolio repriced downward due to the FOMC actions that have maintained the prime rate at 3.25% for the past year coupled with the market dictating that new loan generation occurred at lower rates than during 2008. Interest and dividend income generated from the investment portfolio and interest bearing cash deposits decreased $257,000. The decrease was the result of a minimal decrease in the yield on the investment portfolio of 3 basis points (bp) in conjunction with the average balance of the investment portfolio decreasing by $2,137,000. Dividend and other interest income decreased $574,000 to $194,000 for the year ended December 31, 2009. The decrease is the result of the FHLB ceasing to pay dividends on its stock, a reduction in equity holdings of $5,470,000, and a general reduction in the dividends paid by the various equity holdings.

Interest expense decreased $2,434,000 to $12,398,000 for the year ended December 31, 2009 compared to 2008. Leading the decrease in interest expense was a decline of 14.33% or $1,386,000 related to deposits. The FOMC actions noted previously together with a strategic shortening of the duration of the portfolio led to a 108 bp decline in the rate paid on time deposits from 3.92% for the year ended December 31, 2008 to 2.84% for the year ended December 31, 2009 resulting in a $1,633,000 decline in expense, while the average balance of time deposits increased $18,692,000. Growth in the average balance of money market deposits of $31,985,000 resulted in an increase in interest expense of $528,000 despite a decline of 31 bp in rate. The overall growth in average deposit balances of $58,642,000 allowed for a reduction in average short-term borrowings of $22,904,000 which coupled with a reduction in rate paid on such borrowings of 89 bp resulted in interest expense on short-term borrowings decreasing $785,000.

2008 vs 2007

Reported net interest income increased $1,774,000 or 9.10% to $21,276,000 for the year ended December 31, 2008 compared to the year ended December 31, 2007, although the yield on earning assets decreased to 6.68% from 6.91%, respectively. On a tax equivalent basis the change in net interest income was an increase of $2,078,000 or 9.48% to $23,990,000 for the year ended December 31, 2008 compared to the year ended December 31, 2007. Total interest income increased $159,000 primarily due to growth in the average balance of the loan and securities portfolios. The increase in earning asset volume compensated for the negative impact on earning asset yields caused by the rate reductions enacted by the FOMC. Interest income recognized on the loan portfolio decreased $871,000 as a portion of the portfolio repriced downward due to the FOMC actions that lowered the prime rate from 7.25% at December 31, 2007 to 3.25% at December 31, 2008 coupled with the market dictating that new loan generation occurred at lower rates than during 2007. Interest and dividend income generated from the investment portfolio and interest bearing cash deposits increased $1,030,000. The increase was the result of the yield on the investment portfolio increasing 12 basis points (bp) while the average balance of the investment portfolio increased by $17,067,000. The majority of the increase in the securities portfolio was from a leverage strategy undertaken during the second half of 2007.

Interest expense decreased $1,615,000 to $14,832,000 for the year ended December 31, 2008 compared to 2007. Leading the decrease in interest expense was a decline of 11.70% or $1,281,000 related to deposits. The FOMC actions noted previously together with a strategic shortening of the duration of the portfolio led to an 81 bp decline in the rate paid on time deposits from 4.73% for the year ended December 31, 2007 to 3.92% for the year ended December 31, 2008 resulting in a $1,502,000 decline in expense. The economic turmoil experienced over the past year has led to a significant decline in short-term interest rates which has allowed for a 214 bp decline in the rate paid on short-term borrowings. Several long-term debt maturities paved the way for a decline in the rate paid on long-term borrowings of 23 bp to 4.39% for the year ended December 31, 2008 versus 4.62% for the year ended December 31, 2007.

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AVERAGE BALANCES AND INTEREST RATES

The following tables set forth certain information relating to the Company s average balance sheet and reflect the average yield on assets and average cost of liabilities for the periods indicated and the average yields earned and rates paid. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented.

AVERAGE BALANCES AND INTEREST RATES

	2009			2008			2007		
(In Thousands)	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets:									
Tax-exempt loans	$ 16,688	$ 1,100	6.59%	$ 9,230	$ 603	6.53%	$ 7,857	$ 485	6.17%
All other loans	382,433	24,842	6.50%	361,945	24,830	6.86%	353,528	25,779	7.29%
Total loans	399,121	25,942	6.50%	371,175	25,433	6.85%	361,385	26,264	7.27%
Taxable investment securities	103,338	5,617	5.44%	104,245	6,008	5.76%	93,480	5,474	5.86%
Tax-exempt investment securities	104,800	7,583	7.24%	106,030	7,380	6.96%	99,728	6,602	6.62%
Total securities	208,138	13,200	6.34%	210,275	13,388	6.37%	193,208	12,076	6.25%
Interest-bearing deposits	1,938	1	0.05%	10	1	10.00%	345	19	5.51%
Total interest-earning assets	609,197	39,143	6.43%	581,460	38,822	6.68%	554,938	38,359	6.91%
Other assets	54,642			50,779			42,602		
Total assets	$ 663,839			$ 632,239			$ 597,540		
Liabilities and shareholders equity:									
Savings	$ 60,815	313	0.51%	$ 60,324	443	0.73%	$ 58,710	428	0.73%
Super Now deposits	58,591	507	0.87%	52,117	658	1.26%	46,596	611	1.31%
Money market deposits	62,906	1,227	1.95%	30,921	699	2.26%	23,920	540	2.26%
Time deposits	219,264	6,237	2.84%	200,572	7,870	3.92%	198,029	9,372	4.73%
Total interest-bearing deposits	401,576	8,284	2.06%	343,934	9,670	2.81%	327,255	10,951	3.35%
Short-term borrowings	27,641	396	1.42%	50,545	1,181	2.31%	36,816	1,639	4.45%
Long-term borrowings, FHLB	86,778	3,718	4.23%	89,256	3,981	4.39%	83,490	3,857	4.62%
Total borrowings	114,419	4,114	3.55%	139,801	5,162	3.64%	120,306	5,496	4.57%
Total interest-bearing liabilities	515,995	12,398	2.39%	483,735	14,832	3.05%	447,561	16,447	3.67%
Demand deposits	74,618			73,618			69,953		
Other liabilities	10,169			8,282			6,924		
Shareholders equity	63,057			66,604			73,102		
Total liabilities and shareholders equity	$ 663,839			$ 632,239					
							$ 597,540		
Interest rate spread			4.03%			3.63%			3.24%
Net interest income/margin		$ 26,745	4.40%		$ 23,990	4.14%		$ 21,912	3.95%

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- Fees on loans are included with interest on loans. Loan fees are included in interest income as follows: 2009-$349,000, 2008-$472,000, 2007-$453,000.
- Information on this table has been calculated using average daily balance sheets to obtain average balances.
- Nonaccrual loans have been included with loans for the purpose of analyzing net interest earnings.
- Income and rates on a fully taxable equivalent basis include an adjustment for the difference between annual income from tax-exempt obligations and the taxable equivalent of such income at the standard 34% tax rate.

Reconcilement of Taxable Equivalent Net Interest Income

(In Thousands)	2009	2008	2007
Total interest income	$ 36,191	$ 36,108	$ 35,949
Total interest expense	12,398	14,832	16,447
Net interest income	23,793	21,276	19,502
Tax equivalent adjustment	2,952	2,714	2,410
Net interest income (fully taxable equivalent)	$ 26,745	$ 23,990	$ 21,912

Rate/Volume Analysis

The table below sets forth certain information regarding changes in our interest income and interest expense for the periods indicated. For interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in average volume multiplied by old rate) and (ii) changes in rates (changes in rate multiplied by old average volume). Increases and decreases due to both interest rate and volume, which cannot be separated, have been allocated proportionally to the change due to volume and the change due to interest rate. Income and interest rates are on a taxable equivalent basis.

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	Year Ended December 31,					
		2009 vs 2008 Increase (Decrease) Due to			2008 vs 2007 Increase (Decrease) Due to	
(In Thousands)	**Volume**	**Rate**	**Net**	**Volume**	**Rate**	**Net**
Interest income:						
Loans, tax-exempt	$ 491	$ 6	$ 497	$ 92	$ 26	$ 118
Loans	1,358	(1,346)	12	638	(1,587)	(949)
Taxable investment securities	(51)	(340)	(391)	621	(87)	534
Tax-exempt investment securities	(87)	290	203	532	246	778
Interest bearing deposits	3	(3)		(27)	9	(18)
Total interest-earning assets	1,714	(1,393)	321	1,856	(1,393)	463
Interest expense:						
Savings deposits	4	(134)	(130)	12	3	15
Super Now deposits	75	(226)	(151)	71	(24)	47
Money market deposits	636	(108)	528	158	1	159
Time deposits	682	(2,315)	(1,633)	119	(1,621)	(1,502)
Short-term borrowings	(425)	(360)	(785)	484	(942)	(458)
Long-term borrowings, FHLB	(113)	(150)	(263)	260	(136)	124
Total interest-bearing liabilities	859	(3,293)	(2,434)	1,104	(2,719)	(1,615)
Change in net interest income	$ 855	$ 1,900	$ 2,755	$ 752	$ 1,326	$ 2,078

PROVISION FOR LOAN LOSSES

2009 vs 2008

The provision for loan losses is based upon management s quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Bank. Management remains committed to an aggressive program of problem loan identification and resolution.

The allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management s consideration of the nature of the portfolio segments, changes in mix and volume of the loan portfolio, and historical loan loss experience. In addition, management considers industry standards and trends with respect to nonperforming loans and its knowledge and experience with specific lending segments.

Although management believes that it uses the best information available to make such determinations and that the allowance for loan losses is adequate at December 31, 2009, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy or employment and delays in receiving financial information from borrowers could result in increased levels of nonperforming assets and charge-offs, increased loan loss provisions and reductions in interest income. Additionally, as an integral part of the examination process, bank regulatory agencies periodically review the Bank s loan loss allowance adequacy. The banking regulators could require the recognition of additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

While determining the appropriate allowance level, management has attributed the allowance for loan losses to various portfolio segments; however, the allowance is available for the entire portfolio as needed.

The allowance for loan losses increased from $4,356,000 at December 31, 2008 to $4,657,000 at December 31, 2009. At December 31, 2009, allowance for loan losses was 1.15% of total loans compared to 1.14% of total loans at December 31, 2008.

The provision for loan losses totaled $917,000 for the year ended December 31, 2009 compared to $375,000 for the year ended December 31, 2008. The increase of the provision was appropriate when considering the gross loan growth experienced during 2009 of $24,051,000 coupled with net charge-offs of $616,000 to average loans for the year ended December 31, 2008 of 0.16% compared to $149,000 and 0.04% for the year ended December 31, 2008. In addition, nonperforming loans increased to $4,456,000 from $1,735,000 at December 31, 2008 primarily due to a commercial real estate loan. The loan is collateralized with no loss anticipated at this time. Continued uncertainty surrounding the economy and internal loan review and analysis, coupled with the ratios noted previously, dictated an increase in the provision for loan losses. The increase did not equate to the increase in charge-offs and nonperforming loans due to the collateral status of the nonperforming loans and overall loan portfolio in general, which limits the loan specific allocation of the allowance for loan losses. Utilizing both internal and external resources, as noted, senior management has concluded that the allowance for loan losses remains at a level adequate to provide for probable losses inherent in the loan portfolio.

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2008 vs 2007

The allowance for loan losses increased from $4,130,000 at December 31, 2007 to $4,356,000 at December 31, 2008. At December 31, 2008, allowance for loan losses was 1.14% of total loans compared to 1.15% of total loans at December 31, 2007.

The provision for loan losses totaled $375,000 for the year ended December 31, 2008 compared to $150,000 for the year ended December 31, 2007. Management concluded that the increase of the provision was appropriate when considering the gross loan growth experienced during 2008 of $21,000,000 coupled with net charge-offs to average loans for the year ended December 31, 2008 of 0.04%. Utilizing both internal and external resources, as noted, senior management has concluded that the allowance for loan losses remains at a level adequate to provide for probable losses inherent in the loan portfolio.

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Following is a table showing the changes in the allowance for loan losses for the years ended December 31, 2009, 2008, 2007, 2006, and 2005:

(In Thousands)	2009	2008	2007	2006	2005
Balance at beginning of period	$ 4,356	$ 4,130	$ 4,185	$ 3,679	$ 3,338
Charge-offs:					
Real estate	374	48		50	132
Commercial and industrial	133	51	103	28	206
Installment loans to individuals	225	214	201	249	108
Total charge-offs	732	313	304	327	446
Recoveries:					
Real estate	14	17	13	68	45
Commercial and industrial	10	60	1	40	8
Installment loans to individuals	92	87	85	90	14
Total recoveries	116	164	99	198	67
Net charge-offs	616	149	205	129	379
Additions charged to operations	917	375	150	635	720
Balance at end of period	$ 4,657	$ 4,356	$ 4,130	$ 4,185	$ 3,679
Ratio of net charge-offs during the period to average loans outstanding during the period	0.16%	0.04%	0.06%	0.04%	0.11%

NON-INTEREST INCOME

2009 vs 2008

Total non-interest income decreased $3,169,000 from the year ended December 31, 2008 to 2009. Excluding security losses, non-interest income decreased $354,000 year over year. Service charges decreased as overdraft protection fees decreased $44,000 and customers continued to migrate to checking accounts having reduced or no service charges. Earnings on bank-owned life insurance increased due to the full year impact of policies purchased during 2008 and a gain on death benefit. Insurance commissions decreased due to the general economic downturn, which has led to a decrease in volume of sales. Management of The M Group continues to pursue new and build upon current relationships. However, the sales cycle for insurance and investment products can take typically from six months to one year or more to complete. The increase in other income was primarily due to increases in revenues from debit/credit card transactions and merchant card commissions.

	2009		2008		Change	
(In Thousands)	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**%**
Deposit service charges	$ 2,200	96.20%	$ 2,289	41.95%	$ (89)	(3.89)%
Securities losses, net	(4,846)	(211.89)	(2,031)	(37.23)	(2,815)	(138.60)
Bank owned life insurance	713	31.18	472	8.65	241	51.06
Gain on sale of loans	826	36.12	882	16.17	(56)	(6.35)
Insurance commissions	1,189	51.99	1,928	35.34	(739)	(38.33)
Other	2,205	96.40	1,916	35.12	289	15.08
Total non-interest income	$ 2,287	100.00%	$ 5,456	100.00%	$ (3,169)	(58.08)%

2008 vs 2007

Total non-interest income decreased $2,022,000 from the year ended December 31, 2007 to 2008. Excluding security losses, non-interest income decreased $45,000. Service charges increased as overdraft protection fees increased $100,000 and offset customer migrations to checking accounts having reduced or no service charges. Earnings on bank-owned life insurance increased as additional policies were purchased. Insurance commissions decreased due to the general economic downturn, which has led to a decrease in volume of sales. Management of The M Group continues to pursue new and build upon current relationships. However, the sales cycle for insurance and investment products can take typically from six months to one year or more to complete. The increase in other income was primarily due to increases in revenues from debit card transactions, merchant card commissions, and title insurance.

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	2008		2007		Change	
(In Thousands)	Amount	% Total	Amount	% Total	Amount	%
Deposit service charges	$ 2,289	41.95%	$ 2,246	30.03%	$ 43	1.91%
Securities losses, net	(2,031)	(37.23)	(54)	(0.72)	(1,977)	(3,661.11)
Bank owned life insurance	472	8.65	410	5.48	62	15.12
Gain on sale of loans	882	16.17	921	12.32	(39)	(4.23)
Insurance commissions	1,928	35.34	2,222	29.72	(294)	(13.23)
Other	1,916	35.12	1,733	23.17	183	10.56
Total non-interest income	$ 5,456	100.00%	$ 7,478	100.00%	$ (2,022)	(27.04)%

NON-INTEREST EXPENSE

2009 vs 2008

Total non-interest expenses increased $1,863,000 from the year ended December 31, 2008 to December 31, 2009. Salaries and employee benefits increased due to several factors including standard cost of living wage adjustments for employees and increased benefit costs. Pennsylvania shares tax increased due to tax credits associated with an investment in low income housing within the Lycoming County market that were utilized during 2008. Other expenses increased primarily due to an increase in FDIC insurance expense of $1,010,000.

	2009		2008		Change	
(In Thousands)	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**%**
Salaries and employee benefits	$ 10,189	51.43%	$ 9,634	53.67%	$ 555	5.76%
Occupancy, net	1,266	6.39	1,288	7.18	(22)	(1.71)
Furniture and equipment	1,212	6.12	1,182	6.59	30	2.54
Pennsylvania shares tax	685	3.46	421	2.35	264	62.71
Amortization of investment in limited partnerships	567	2.86	712	3.97	(145)	(20.37)
Other	5,893	29.74	4,712	26.24	1,181	25.06
Total non-interest expense	$ 19,812	100.00%	$ 17,949	100.00%	$ 1,863	10.40%

2008 vs 2007

Total non-interest expenses increased $633,000 from the year ended December 31, 2007 to December 31, 2008. Salaries and employee benefits increased due to several factors including standard cost of living wage adjustments for employees, increased benefit costs, and expenses associated with the post-retirement segment of split-dollar bank owned life insurance. Pennsylvania shares tax decreased due to tax credits associated with an investment in low income housing within the Lycoming County market. Other expenses increased primarily due to increases in legal and insurance costs coupled with our continued emphasis on giving back to the communities that we serve resulting in a doubling of donations during 2008 compared to 2007.

	2008		2007		Change	
(In Thousands)	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**%**
Salaries and employee benefits	$ 9,634	53.67%	$ 9,078	52.43%	$ 556	6.12%
Occupancy, net	1,288	7.18	1,306	7.54	(18)	(1.38)
Furniture and equipment	1,182	6.59	1,126	6.50	56	4.97
Pennsylvania shares tax	421	2.35	643	3.71	(222)	(34.53)
Amortization of investment in limited partnerships	712	3.97	761	4.39	(49)	(6.44)
Other	4,712	26.24	4,402	25.43	310	7.04
Total non-interest expense	$ 17,949	100.00%	$ 17,316	100.00%	$ 633	3.66%

INCOME TAXES

2009 vs 2008

The provision for income taxes for the year ended December 31, 2009 resulted in an effective income tax rate of (13.9)% compared to 4.8% for 2008. This decrease is primarily the result of an increase in net securities losses of $2,815,000 which accounted for a reduction

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in tax expense of approximately $957,000. In addition, tax-exempt investment income and bank-owned life insurance income increased $134,000 and $241,000, respectively resulting in approximately and additional reduction in tax expense of $128,000.

An analysis has been performed to determine if there is a need for a valuation allowance related to the deferred tax asset that has been booked due to the investment losses. As of December 31, 2009, management determined that a valuation analysis was not necessary.

2008 vs 2007

The provision for income taxes for the year ended December 31, 2008 resulted in an effective income tax rate of 4.8% compared to 6.7% for 2007. This decrease is the result of the continued shift in the investment portfolio from taxable mortgage-backed bonds to tax-exempt municipal bonds coupled with the recognition of tax credits related to low income housing partnerships investments.

FINANCIAL CONDITION

INVESTMENTS

2009

The carrying value of the investment portfolio increased $489,000 from December 31, 2008 to 2009, while the amortized cost decreased $6,955,000 over the same period. The decrease in amortized value was due to a reduction of U.S. Government and agency securities due to routine principal payments and a reduction in equity securities due to both other than temporary impairment write downs and that certain positions were liquidated to maximize the ability to carry back capital losses for tax purposes. Offsetting these decreases in part was an increase in state and political securities. This segment of the aggregate portfolio was increased due to its ability to complement the shorter duration assets within the earning asset composition. The increase in carrying or fair value was the result of the previously noted reduction in amortized cost offset by a reduction in aggregate net unrealized losses of $7,451,000 primarily related to the equity segment of the portfolio.

2008

The carrying value of the investment portfolio decreased $6,346,000 or 2.96% from December 31, 2007 to 2008, while the amortized cost increased $3,241,000 over the same period. The majority of the changes in value occurred within the state and municipal segment of the portfolio. The amortized cost position in state and political securities increased $22,607,000 as the Bank continued to build call protection, maintain taxable equivalent yields, reduce the effective federal income tax rate, and invest in communities across the Commonwealth of Pennsylvania and the country. The amortized cost position of U.S. Government and agency securities decreased $15,934,000 due to the focus on building the municipal bond segment of the portfolio. The increased level of unrealized losses, which offset the increase in amortized cost, was the result of changes in the yield curve and illiquid markets, not credit quality, as the credit quality of the portfolio remained sound.

The carrying amounts of investment securities are summarized as follows for the years ended December 31, 2009, 2008, and 2007:

	2009		2008		2007	
(In Thousands)	**Balance**	**% Portfolio**	**Balance**	**% Portfolio**	**Balance**	**% Portfolio**
U.S. Government agencies:						
Held to maturity	$ 6	0.00%	$ 10	0.00%	$ 14	0.01%
Available for sale	39,136	18.74%	47,586	22.84%	62,904	29.29%
State and political subdivisions (tax-exempt):						
Held to maturity						
Available for sale	106,928	51.19%	103,173	49.51%	107,314	49.98%
State and political subdivisions (taxable):						
Held to maturity						
Available for sale	37,949	18.17%	28,668	13.76%	10,501	4.89%
Other bonds, notes and debentures:						
Held to maturity	101	0.05%	125	0.06%	263	0.12%
Available for sale	12,976	6.21%	15,554	7.46%	15,767	7.34%
Total bonds, notes and debentures	197,096	94.36%	195,116	93.63%	196,763	91.63%
Corporate stock - Available for Sale	11,779	5.64%	13,270	6.37%	17,969	8.37%
Total	$ 208,875	100.00%	$ 208,386	100.00%	$ 214,732	100.00%

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The following table shows the maturities and repricing of investment securities, at amortized cost and the weighted average yields (for tax-exempt obligations on a fully taxable basis assuming a 34% tax rate) at December 31, 2009:

(In Thousands)	Within One Year	After One But Within Five Years	After Five But Within Ten Years	After Ten Years	Amortized Cost Total
U.S. Government agencies:					
HTM Amount	$	$	$	$ 6	$ 6
Yield				8.62%	8.62%
AFS Amount				37,038	37,038
Yield				5.82%	5.82%
State and political subdivisions (tax-exempt):					
HTM Amount					
Yield					
AFS Amount			1,454	111,159	112,613
Yield			7.98%	6.60%	6.61%
State and political subdivisions (taxable):					
HTM Amount					
Yield					
AFS Amount		1,007		40,294	41,301
Yield		6.01%		5.98%	5.98%
Other bonds, notes and debentures:					
HTM Amount	25	76			101
Yield	7.31%	6.30%			6.55%
AFS Amount	25	10,349	1	1,896	12,271
Yield	0.66%	5.11%	0.90%	6.82	