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, 2011

OR

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

For the transition period from to

Commission file number 0-17077

PENNS WOODS BANCORP, INC.

(Exact name of registrant as specified in its charter)

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. o

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

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

State the aggregate market value of the voting stock held by non-affiliates of the registrant **$131,808,052 at June 30, 2011.**

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 1, 2012**
Common Stock, $8.33 Par Value	3,837,322 Shares

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 25, 2012 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 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 189 persons as of December 31, 2011 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 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 also 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 control of a non-bank subsidiary (other than a non-bank subsidiary of a bank) upon the FRB s determination that such

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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

The Bank is highly regulated by the FDIC and the Pennsylvania Department of Banking. The laws that such agencies enforce limit the specific types of businesses in which the Bank may engage, and the products and services that the Bank may offer to customers. Generally, these limitations are designed to protect the insurance fund of the FDIC and/or the customers of the Bank, and not the Bank or its shareholders. From time to time, various types of new 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. Some of the major regulatory provisions that affect the business of the Bank are discussed briefly below.

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

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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 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 DIF by assessing depository institutions an insurance premium. The amount each institution was assessed is based upon a variety of factors that included the balance of insured deposits as well as the degree of risk the institution possessed to the insurance fund. As a result of the enactment of the Emergency Economic Stabilization Act of 2008, the FDIC temporarily increased the amount of deposits it insures from $100,000 to $250,000. This increase has been made permanent. The Bank paid an insurance premium into the DIF based on the quarterly average daily deposit liabilities net of certain exclusions. The FDIC used a risk-based premium system that assessed higher rates on those institutions that posed a greater risk to the DIF. The FDIC placed 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 was 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 were applied to the adjusted assessment.

Beginning with the second quarter of 2011, as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the assessment base that the FDIC uses to calculate assessment premiums became a bank s average assets minus average tangible equity. As the asset base of the banking industry is larger than the deposit base, the range of assessment rates will change to a low or 2.5 basis points to a high of 45 basis points, per $100 of assets; however, the dollar amount of the actual premiums is expected to be roughly the same.

The FDIC is required under the Dodd-Frank Act to establish assessment rates that will allow the Deposit Insurance Fund to achieve a reserve ratio of 1.35% of Insurance Fund insured deposits by September 2020. In addition, the FDIC has established a designated reserve ratio of 2.0%, a target ratio that, until it is achieved, will not likely result in the FDIC reducing assessment rates. In attempting to achieve the mandated 1.35% ratio, the FDIC is required to implement assessment formulas that charge banks over $10 billion in asset size more than banks under that size. Those new formulas began in the second quarter of 2011, but did not affect the Bank. Under the Dodd-Frank Act, the FDIC is authorized to make reimbursements from the insurance fund to banks if the reserve ratio exceeds 1.50%, but the FDIC has adopted the designated reserve ratio of 2.0% and has announced that any reimbursements from the fund are indefinitely suspended.

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 $1,233,000 at December 31, 2011.

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, 2011, the Bank had $77,723,000 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, 2011, the Bank had $5,626,000 million in stock of the FHLB which was in compliance with this requirement.

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Recent Legislation

The Dodd-Frank Act was enacted on July 21, 2010. This new law will significantly change the current bank regulatory structure and affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies.

The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. The federal agencies are given significant discretion in drafting such rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for some time.

Certain provisions of the Dodd-Frank Act are expected to have a near term impact on the Company. For example, effective July 21, 2011, a provision of the Dodd-Frank Act eliminated the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on the Company s interest expense.

The Dodd-Frank Act also broadens the base for FDIC insurance assessments. Under the Dodd-Frank Act, the assessment base will no longer be an institution s deposit base, but rather its average consolidated total assets less its average tangible equity during the assessment period. The Dodd-Frank Act also permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2008, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2013.

Bank and thrift holding companies with assets of less than $15 billion as of December 31, 2009, such as the Company, will be permitted to include trust preferred securities that were issued before May 19, 2010, as Tier 1 capital; however, trust preferred securities issued by a bank or thrift holding company (other than those with assets of less than $500 million) after May 19, 2010, will no longer count as Tier 1 capital. Trust preferred securities still will be entitled to be treated as Tier 2 capital.

The Dodd-Frank Act requires publicly traded companies to give shareholders a non-binding vote on executive compensation and so-called golden parachute arrangements, and may allow greater access by shareholders to the company s proxy material by authorizing the SEC to promulgate rules that would allow shareholders to nominate their own candidates using a company s proxy materials. The legislation also directs the FRB to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded.

The Dodd-Frank Act creates a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit unfair, deceptive or abusive acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets such as the Bank will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

It is difficult to predict at this time the specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on financial institutions operations is presently unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

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 bureaus, 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 often considering some financial industry legislation, and the federal banking agencies routinely propose new regulations. The Company cannot predict how any new legislation, or new rules adopted by federal or state banking agencies, may affect the business of the Company and its subsidiaries in the future. Given that the financial industry remains under stress and severe scrutiny, and given that the U.S. economy has not yet fully recovered to pre-crisis levels of activity, the Company expects that there will be significant legislation and regulatory actions that may materially affect the banking industry for the foreseeable future.

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

The 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, 2011, the Bank had total assets of $753,288,000; total shareholders equity of $67,770,000; and total deposits of $583,569,000. The Bank s deposits are insured by the FDIC for the maximum amount provided under current law.

The Bank engages in business as a commercial bank, doing business at locations in Lycoming, Clinton, Centre, and Montour Counties, Pennsylvania. The Bank offers insurance, securities brokerage services, annuity and mutual fund investment products, and financial planning through the M 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

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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.

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, Centre, and Montour 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

As referenced elsewhere, the banking business is highly regulated, and the Bank is only able to engage in business activities, and to provide products and services, that are permitted by applicable law and regulation. In addition, 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 income/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/loss 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 cannot predict the ultimate effect of these changes, which could have a material adverse effect on our profitability or financial condition.

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In response to the financial crisis that commenced in 2008, Congress has taken actions that are intended to strengthen confidence and encourage liquidity in financial institutions, and the FDIC has taken actions to increase insurance coverage on deposit accounts. The Dodd-Frank Act provides for the creation of a consumer protection division at the Board of Governors of the Federal Reserve System that will have broad authority to issue regulations governing the services and products we provide consumers. This additional regulation could increase our compliance costs and otherwise adversely impact our operations. That legislation also contains provisions that, over time, could result in higher regulatory capital requirements and loan loss provisions for the Bank, and may increase interest expense due to the ability granted in July 2011 to pay interest on all demand deposits. In addition, there have been proposals made by members of Congress and others that would reduce the amount delinquent borrowers are otherwise contractually obligated to pay under their mortgage loans and limit an institution s ability to foreclose on mortgage collateral. These proposals could result in credit losses or increased expense in pursuing our remedies as a creditor. Recent regulatory changes impose limits on our ability to charge overdraft fees, which may decrease our non-interest income as compared to more recent prior periods.

The potential exists for additional federal or state laws and regulations, or changes in policy, affecting many aspects of our operations, including capital levels, lending and funding practices, and liquidity standards. New laws and regulations may increase our costs of regulatory compliance and of doing business and otherwise affect our operations, and may significantly affect the markets in which we do business, the markets for and value of our loans and investments, the fees we can charge and our ongoing operations, costs and profitability.

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 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.

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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, 2011, 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		Owned
		Montgomery, Pennsylvania 17752		
Lock Haven		4 West Main Street		Owned
		Lock Haven, Pennsylvania 17745		
Mill Hall		(Inside Wal-Mart), 173 Hogan Boulevard		Under Lease
		Mill Hall, Pennsylvania 17751		
Spring Mills		3635 Penns Valley Road, P.O. Box 66		Owned
		Spring Mills, Pennsylvania 16875		
Centre Hall		2842 Earlystown Road		Land Under Lease
		Centre Hall, Pennsylvania 16828		
Zion		100 Cobblestone Road		Under Lease
		Bellefonte, Pennsylvania 16823		
State College		2050 North Atherton Street		Land Under Lease

		State College, Pennsylvania 16803		
Montoursville		820 Broad Street		Under Lease
		Montoursville, Pennsylvania 17754		
Danville		606 Continental Boulevard		Under Lease
		Danville, PA 17821		
The M Group, Inc. D/B/A The Comprehensive Financial Group		705 Washington Boulevard		Under Lease
		Williamsport, Pennsylvania 17701		

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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 MINE SAFETY DISCLOSURES

Not applicable

PART II

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

The Company s 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, 2009. 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.

	High	Low	Dividends Declared
2011			
First quarter	$ 40.08	$ 35.46	$ 0.46
Second quarter	39.30	33.33	0.46
Third quarter	36.56	31.07	0.46
Fourth quarter	39.30	32.01	0.46
2010			
First quarter	$ 34.03	$ 30.04	$ 0.46
Second quarter	34.50	26.76	0.46
Third quarter	33.15	29.41	0.46
Fourth quarter	41.26	31.97	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 Company 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 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 1, 2012, the Company had approximately 1,255 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 2011.

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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, 2011)		$		76,776
Month #2 (November 1 - November 30, 2011)				76,776
Month #3 (December 1 - December 31, 2011)				76,776

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, 2006 and assuming the reinvestment of dividends. The shareholder return shown on the graph below is not necessarily indicative of future performance.

	Period Ending					
Index	**12/31/06**	**12/31/07**	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**

Penns Woods Bancorp, Inc.	100.00	90.74	68.39	102.58	133.02	136.35
S&P 500	100.00	105.49	66.46	84.05	96.71	98.76
NASDAQ Composite	100.00	110.66	66.42	96.54	114.06	113.16
NASDAQ Bank	100.00	80.09	62.84	52.60	60.04	53.74

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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, 2011.

(In Thousands, Except Per Share Data Amounts)	2011	2010	2009	2008	2007
Consolidated Statement of Income Data:					
Interest income	$ 36,376	$ 36,362	$ 36,191	$ 36,108	$ 35,949
Interest expense	7,656	9,868	12,398	14,832	16,447
Net interest income	28,720	26,494	23,793	21,276	19,502
Provision for loan losses	2,700	2,150	917	375	150
Net interest income after provision for loan losses	26,020	24,344	22,876	20,901	19,352
Noninterest income	8,219	7,459	2,287	5,456	7,478
Noninterest expense	19,964	19,492	19,812	17,949	17,316
Income before income taxes	14,275	12,311	5,351	8,408	9,514
Applicable income taxes	1,913	1,382	(742)	405	637
Net Income	$ 12,362	$ 10,929	$ 6,093	$ 8,003	$ 8,877
Consolidated Balance Sheet at End of Period:					
Total assets	$ 763,953	$ 691,688	$ 676,204	$ 652,803	$ 628,138
Loans	435,959	415,557	405,529	381,478	360,478
Allowance for loan losses	(7,154)	(6,035)	(4,657)	(4,356)	(4,130)
Deposits	581,664	517,508	497,287	421,368	389,022
Long-term debt	61,278	71,778	86,778	86,778	106,378
Shareholders equity	80,460	66,620	66,916	61,027	70,559
Per Share Data:					
Earnings per share - Basic	$ 3.22	$ 2.85	$ 1.59	$ 2.07	$ 2.28
Earnings per share - Diluted	3.22	2.85	1.59	2.07	2.28
Cash dividends declared	1.84	1.84	1.84	1.84	1.79
Book value	20.97	17.37	17.45	15.93	18.21
Number of shares outstanding, at end of period	3,837,081	3,835,157	3,834,114	3,831,500	3,875,632
Average number of shares outstanding-basic	3,836,036	3,834,255	3,832,789	3,859,724	3,886,277
Selected Financial Ratios:					
Return on average shareholders equity	16.60%	15.30%	9.66%	12.02%	12.14%
Return on average total assets	1.69%	1.56%	0.92%	1.27%	1.49%
Net interest margin	4.70%	4.57%	4.40%	4.14%	3.95%
Dividend payout ratio	57.10%	64.56%	115.74%	88.67%	78.33%
Average shareholders equity to average total assets	10.18%	10.19%	9.50%	10.53%	12.23%
Loans to deposits, at end of period	74.95%	80.30%	81.55%	90.53%	92.66%

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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 2011, 2010, and 2009 were $3,122,000, $3,018,000, and $2,952,000, respectively.

2011 vs 2010

Reported net interest income increased $2,226,000 or 8.40% to $28,720,000 for the year ended December 31, 2011 compared to the year ended December 31, 2010, although the yield on earning assets decreased to 5.82% from 6.08% respectively. On a tax equivalent basis, the change in net interest income was an increase of $2,330,000 or 7.90% to $31,842,000 for the year ended December 31, 2011 compared to the year ended December 31, 2010. Total interest income remained steady as the impact of growth in the average balance of the loan and investment portfolios was offset by a decline in the portfolio yields caused by the prolonged low interest rate cycle enacted by the Federal Open Markets Committee (FOMC). Interest income recognized on the loan portfolio decreased $326,000 as a portion of the portfolio repriced downward due to the FOMC actions that have maintained the prime rate at 3.25% dictating that new loan generation occurred at lower rates than the existing portfolio. Interest and dividend income generated from the investment portfolio and interest bearing cash deposits increased $340,000. The increase was driven by portfolio growth, which more than compensated for a decrease in yield of 35 basis points (bp).

Interest expense decreased $2,212,000 to $7,656,000 for the year ended December 31, 2011 compared to 2010. Leading the decrease in interest expense was a decline of 24.59% or $1,489,000 related to deposits. The FOMC actions noted previously together with a strategic focus on core deposits led to a 39 bp decline in the rate paid on interest-bearing deposits from 1.38% for the year ended December 31, 2010 to 0.99% for the year ended December 31, 2011. Leading the significant decline in interest-bearing deposit expense was a decline in the cost of time deposits of 45 bp s. The overall growth in average deposit balances of $37,344,000 allowed for a reduction in average long-term borrowings of $14,022,000 leading to a reduction in borrowed funds interest expense of $723,000.

2010 vs 2009

Reported net interest income increased $2,701,000 or 11.35% to $26,494,000 for the year ended December 31, 2010 compared to the year ended December 31, 2009, although the yield on earning assets decreased to 6.08% from 6.43% respectively. On a tax equivalent basis, the change in net interest income was an increase of $2,767,000 or 10.35% to $29,512,000 for the year ended December 31, 2010 compared to the year ended December 31, 2009. Total interest income increased $171,000 due to growth in the average balance of the loan and investment portfolios. 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 FOMC. Interest income recognized on the loan portfolio decreased $55,000 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 2009. Interest and dividend income generated from the investment portfolio and interest bearing cash deposits increased $226,000. The increase was driven by portfolio growth, which more than compensated for a decrease in yield of 29 bp.

Interest expense decreased $2,530,000 to $9,868,000 for the year ended December 31, 2010 compared to 2009. Leading the decrease in interest expense was a decline of 26.91% or $2,229,000 related to deposits. The FOMC actions noted previously together with a strategic shortening of the duration of the portfolio led to a 77 bp decline in the rate paid on time deposits from 2.84% for the year ended December 31, 2009 to 2.07% for the year ended December 31, 2010 resulting in a $1,917,000 decline in expense, while the average balance of time deposits

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decreased $10,990,000. Growth in the average balance of money market deposits of $37,206,000 was offset by a decline of 78 bp in rate resulting in a decrease in interest expense of $60,000. The overall growth in average deposit balances of $36,367,000 allowed for a reduction in average short-term borrowings of $12,270,000 and a reduction in average long-term borrowings of $2,877,000 leading to a reduction in borrowed funds interest expense of $170,000.

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.

	2011			2010			2009		
(In Thousands)	**Average Balance**	**Interest**	**Average Rate**	**Average Balance**	**Interest**	**Average Rate**	**Average Balance**	**Interest**	**Average Rate**
Assets:									
Tax-exempt loans	$ 20,267	$ 1,213	5.99%	$ 18,287	$ 1,212	6.63%	$ 16,688	$ 1,100	6.59%
All other loans	405,391	24,386	6.02%	397,766	24,713	6.21	382,433	24,842	6.50
Total loans	425,658	25,599	6.01%	416,053	25,925	6.23	399,121	25,942	6.50
Taxable securities	130,647	5,926	4.54%	113,714	5,784	5.09	103,338	5,617	5.44
Tax-exempt securities	113,184	7,970	7.04%	108,658	7,665	7.05	104,800	7,583	7.24
Total securities	243,831	13,896	5.70%	222,372	13,449	6.05	208,138	13,200	6.34
Interest-bearing deposits	9,074	3	0.03%	8,782	6	0.07	1,938	1	0.05
Total interest-earning assets	678,563	39,498	5.82%	647,207	39,380	6.08	609,197	39,143	6.43
Other assets	53,207			53,734			54,642		
Total assets	$ 731,770			$ 700,941			$ 663,839		
Liabilities and shareholders equity:									
Savings	$ 70,178	121	0.17%	$ 64,477	183	0.28	$ 60,815	313	0.51
Super Now deposits	88,556	473	0.53%	65,080	385	0.59	58,591	507	0.87
Money market deposits	121,458	1,063	0.88%	100,112	1,167	1.17	62,906	1,227	1.95
Time deposits	179,336	2,909	1.62%	208,274	4,320	2.07	219,264	6,237	2.84
Total interest-bearing deposits	459,528	4,566	0.99%	437,943	6,055	1.38	401,576	8,284	2.06
Short-term borrowings	18,117	202	1.11%	15,371	265	1.72	27,641	396	1.42
Long-term borrowings, FHLB	69,879	2,888	4.08%	83,901	3,548	4.17	86,778	3,718	4.23
Total borrowings	87,996	3,090	3.47%	99,272	3,813	3.79	114,419	4,114	3.55
	547,524	7,656	1.39%	537,215	9,868	1.83	515,995	12,398	2.39

Total interest-bearing liabilities									
Demand deposits	99,917			84,158			74,618		
Other liabilities	9,852			8,118			10,169		
Shareholders equity	74,477			71,450			63,057		
Total liabilities and shareholders equity	$ 731,770			$ 700,941			$ 663,839		
Interest rate spread			4.43%			4.25%			4.03%
Net interest income/margin		$ 31,842	4.70%		$ 29,512	4.57%		$ 26,745	4.40%

- Fees on loans are included with interest on loans as follows: 2011 - $306,000, 2010 - $439,000, 2009 - $349,000.
- 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)	**2011**	**2010**	**2009**
Total interest income	$ 36,376	$ 36,362	$ 36,191
Total interest expense	7,656	9,868	12,398
Net interest income	28,720	26,494	23,793
Tax equivalent adjustment	3,122	3,018	2,952
Net interest income (fully taxable equivalent)	$ 31,842	$ 29,512	$ 26,745

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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.

	Year Ended December 31,					
	2011 vs. 2010 Increase (Decrease) Due to			2010 vs. 2009 Increase (Decrease) Due to		
(In Thousands)	**Volume**	**Rate**	**Net**	**Volume**	**Rate**	**Net**
Interest income:						
Loans, tax-exempt	$ 124	$ (123)	$ 1	$ 105	$ 7	$ 112
Loans	457	(784)	(327)	989	(1,118)	(129)
Taxable investment securities	807	(665)	142	469	(302)	167
Tax-exempt investment securities	318	(13)	305	219	(137)	82
Interest-bearing deposits		(3)	(3)	3	2	5
Total interest-earning assets	1,706	(1,588)	118	1,785	(1,548)	237
Interest expense:						
Savings deposits	15	(77)	(62)	18	(148)	(130)
Super Now deposits	127	(39)	88	51	(173)	(122)
Money market deposits	221	(325)	(104)	552	(612)	(60)
Time deposits	(369)	(1,042)	(1,411)	(294)	(1,623)	(1,917)
Short-term borrowings	39	(102)	(63)	(149)	18	(131)
Long-term borrowings, FHLB	(592)	(68)	(660)	(122)	(48)	(170)
Total interest-bearing liabilities	(559)	(1,653)	(2,212)	56	(2,586)	(2,530)
Change in net interest income	$ 2,265	$ 65	$ 2,330	$ 1,729	$ 1,038	$ 2,767

PROVISION FOR LOAN LOSSES

2011 vs 2010

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, 2011, 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.

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The allowance for loan losses increased from $6,035,000 at December 31, 2010 to $7,154,000 at December 31, 2011. At December 31, 2011, the allowance for loan losses was 1.64% of total loans compared to 1.45% of total loans at December 31, 2010.

The provision for loan losses totaled $2,700,000 for the year ended December 31, 2011 compared to $2,150,000 for the year ended December 31, 2010. The increase of the provision was appropriate when considering the gross loan growth experienced during 2011 of $20,402,000 coupled with net charge-offs of $1,581,000 to average loans for the year ended December 31, 2011 of 0.37% compared to $771,000 and 0.16% for the year ended December 31, 2010. In addition, nonperforming loans increased $5,794,000 to $12,009,000 at December 31, 2011 primarily due to several commercial real estate loans that continued to have or developed financial difficulties. The loans are in a secured position and have sureties with a strong underlying financial position. In addition, a specific allowance within the allowance for loan losses has been established for these loans. Continued uncertainty surrounding the economy, 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.

2010 vs 2009

The allowance for loan losses increased from $4,657,000 at December 31, 2009 to $6,035,000 at December 31, 2010. At December 31, 2010, the allowance for loan losses was 1.45% of total loans compared to 1.15% of total loans at December 31, 2009.

The provision for loan losses totaled $2,150,000 for the year ended December 31, 2010 compared to $917,000 for the year ended December 31, 2009. The increase of the provision was appropriate when considering the gross loan growth experienced during 2010 of $10,028,000 coupled with net charge-offs of $771,000 to average loans for the year ended December 31, 2010 of 0.19% compared to $616,000 and 0.16% for the year ended December 31, 2009. In addition, nonperforming loans increased to $6,215,000 from $4,456,000 at December 31, 2009 primarily due to several commercial real estate loans. The loans are in a secured position and have sureties with a strong underlying financial position. 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.

Following is a table showing the changes in the allowance for loan losses for the years ended December 31, 2011, 2010, 2009, 2008, and 2007:

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(In Thousands)	2011	2010	2009	2008	2007
Balance at beginning of period	$ 6,035	$ 4,657	$ 4,356	$ 4,130	$ 4,185
Charge-offs:					
Real estate	1,589	499	374	48	
Commercial and agricultural	35	266	133	51	103
Installment loans to individuals	87	137	225	214	201
Total charge-offs	1,711	902	732	313	304
Recoveries:					
Real estate	71	24	14	17	13
Commercial and agricultural	10	18	10	60	1
Installment loans to individuals	49	88	92	87	85
Total recoveries	130	130	116	164	99
Net charge-offs	1,581	772	616	149	205
Additions charged to operations	2,700	2,150	917	375	150
Balance at end of period	$ 7,154	$ 6,035	$ 4,657	$ 4,356	$ 4,130
Ratio of net charge-offs during the period to average loans outstanding during the period	0.37%	0.19%	0.16%	0.04%	0.06%

NON-INTEREST INCOME

2011 vs. 2010

Total non-interest income increased $760,000 from the year ended December 31, 2010 to December 31, 2011. Excluding net security gains, non-interest income increased $312,000 year over year. Service charges decreased as customers continued to migrate to checking accounts having reduced or no service charges, while overdraft income declined due to a decreased number of overdrafts. Earnings on bank-owned life insurance decreased due to a non-recurring gain on death benefit recognized in 2010. Insurance and brokerage commissions remained stable as the market for these products begins to rebound. 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 as electronic payment methods continue to gain in popularity.

	2011		2010		Change	
(In Thousands)	Amount	% Total	Amount	% Total	Amount	%
Deposit service charges	$ 2,021	24.59%	$ 2,177	29.19%	$ (156)	(7.17)%
Securities gains, net	621	7.56	173	2.32	448	258.96
Bank-owned life insurance	599	7.29	636	8.53	(37)	(5.82)
Gain on sale of loans	1,130	13.75	949	12.72	181	19.07
Insurance commissions	933	11.35	970	13.00	(37)	(3.81)
Brokerage commissions	997	12.13	965	12.94	32	3.32
Other	1,918	23.33	1,589	21.30	329	20.70
Total non-interest income	$ 8,219	100.00%	$ 7,459	100.00%	$ 760	10.19%

2010 vs. 2009

Total non-interest income increased $5,172,000 from the year ended December 31, 2009 to December 31, 2010. Excluding net security gains/losses, non-interest income increased $153,000 year over year. Service charges decreased as customers continued to migrate to checking accounts having reduced or no service charges. Earnings on bank-owned life insurance decreased due to the differential in non-recurring gains on death benefit recognized in 2010 and 2009. 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.

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	2010		2009		Change	
(In Thousands)	Amount	% Total	Amount	% Total	Amount	%
Deposit service charges	$ 2,177	29.19%	$ 2,200	96.20%	$ (23)	(1.05)%
Securities gains (losses), net	173	2.32	(4,846)	(211.89)	5,019	103.57
Bank-owned life insurance	636	8.53	713	31.18	(77)	(10.80)
Gain on sale of loans	949	12.72	826	36.12	123	14.89
Insurance commissions	970	13.00	1,189	51.99	(219)	(18.42)
Brokerage commissions	965	12.94	768	33.58	197	25.65
Other	1,589	21.30	1,437	62.82	152	10.58
Total non-interest income	$ 7,459	100.00%	$ 2,287	100.00%	$ 5,172	226.15%

NON-INTEREST EXPENSE

2011 vs. 2010

Total non-interest expenses increased $472,000 from the year ended December 31, 2010 to December 31, 2011. Salaries and employee benefits remained stable as a decrease in pension expense and an increase in deferred costs relating to loan generations limited the impact of several factors including standard cost of living wage adjustments for employees and increased benefit costs. Furniture and equipment expense increased due to an increase in general maintenance costs of technology related systems. FDIC deposit insurance expense decreased due to a change in the FDIC assessment from a deposit to asset based calculation. Other expenses increased primarily due to increases in other real estate expenses, donations, and training.

	2011		2010		Change	
(In Thousands)	Amount	% Total	Amount	% Total	Amount	%
Salaries and employee benefits	$ 10,479	52.49%	$ 10,214	52.41%	$ 265	2.59%
Occupancy, net	1,262	6.32	1,240	6.36	22	1.77
Furniture and equipment	1,379	6.91	1,264	6.48	115	9.10
Pennsylvania shares tax	689	3.45	677	3.47	12	1.77
Amortization of investment in limited partnerships	661	3.31	693	3.56	(32)	(4.62)
FDIC deposit insurance	525	2.63	737	3.78	(212)	(28.77)
Other	4,969	24.89	4,667	23.94	302	6.47
Total non-interest expense	$ 19,964	100.00%	$ 19,492	100.00%	$ 472	2.42%

2010 vs. 2009

Total non-interest expenses decreased $320,000 from the year ended December 31, 2009 to December 31, 2010. Salaries and employee benefits remained stable as a decrease in pension expense limited the impact of several factors including standard cost of living wage adjustments for employees and increased benefit costs. Amortization of investment in limited partnerships increased due to a low income elderly housing partnership in our Williamsport market beginning to be amortized in conjunction with the recognition of federal tax credits. Other expenses decreased primarily due to a decrease in FDIC insurance expense of $330,000.

	2010		2009		Change	
(In Thousands)	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**%**
Salaries and employee benefits	$ 10,214	52.41%	$ 10,189	51.43%	$ 25	0.25%
Occupancy, net	1,240	6.36	1,266	6.39	(26)	(2.05)
Furniture and equipment	1,264	6.48	1,212	6.12	52	4.29
Pennsylvania shares tax	677	3.47	685	3.46	(8)	(1.17)
Amortization of investment in limited partnerships	693	3.56	567	2.86	126	22.22
FDIC deposit insurance	737	3.78	1,067	5.39	(330)	(30.93)
Other	4,667	23.94	4,826	24.35	(159)	(3.29)
Total non-interest expense	$ 19,492	100.00%	$ 19,812	100.00%	$ (320)	(1.62)%

INCOME TAXES

2011 vs 2010

The provision for income taxes for the year ended December 31, 2011 resulted in an effective income tax rate of 13.4% compared to 11.2% for 2010. This increase is primarily the result of increased revenue from net interest income and net securities gains that outpaced the increase in non-interest expense.

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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, 2011, management determined that a valuation analysis was not necessary.

2010 vs 2009

The provision for income taxes for the year ended December 31, 2010 resulted in an effective income tax rate of 11.2% compared to (13.9)% for 2009. This increase is primarily the result of an increase in net securities gains of $5,019,000 (to a gain of $173,000 from a loss of $4,846,000) which accounted for an increase in tax expense of approximately $1,706,000.

FINANCIAL CONDITION

INVESTMENTS

2011

The fair value of the investment portfolio increased $54,504,000 from December 31, 2010 to December 31, 2011. The increase was split between an increase in unrealized gain and additions to the amortized cost from purchases during 2011. The increase in amortized cost was primarily the result of purchasing shorter-term other debt securities or corporate bonds. These bonds were purchased due to their shorter maturity and ability to reduce the duration of the total investment portfolio during the continued period of low interest rates. In addition, the growth in the other debt securities segment of the portfolio allowed for the implementation of a barbell strategy with the current municipal portfolio serving as the other end of the barbell or long-term maturity portion of the total investment portfolio. The municipal portfolio had the largest change in unrealized gains as the portfolio moved from an unrealized loss of $15,057,000 at December 31, 2010 to an unrealized gain of $3,511,000 at December 31, 2011 as fewer defaults than predicted occurred and the supply of new issues decreased.

2010

The fair value of the investment portfolio increased $6,772,000 from December 31, 2009 to December 31, 2010 while the amortized cost increased $12,390,000 over the same period. The increase in amortized value was primarily due to an increase in the state and political securities and other debt securities segments of the portfolio. The state and political securities segment of the aggregate portfolio was increased due to its ability to complement the shorter duration assets within the earning asset composition. Other debt securities were utilized as short-term vehicles to utilize cash on hand, while minimizing interest rate risk. The increase in carrying or fair value was the result of the previously noted increase in amortized cost offset by an increase in aggregate net unrealized losses of $5,618,000 primarily related to the state and political securities segment of the portfolio.

The carrying amounts of investment securities are summarized as follows for the years ended December 31, 2011, 2010, and 2009:

	2011		2010		2009	
(In Thousands)	**Balance**	**% Portfolio**	**Balance**	**% Portfolio**	**Balance**	**% Portfolio**
U.S. Government agencies:						
Held to maturity	$	%	$ 5	%	$ 6	%
Available for sale	28,671	10.61	26,613	12.34	39,136	18.74
State and political subdivisions (tax-exempt):						
Held to maturity						
Available for sale	127,678	47.26	101,492	47.06	106,928	51.19
State and political subdivisions (taxable):						
Held to maturity						
Available for sale	50,623	18.74	53,295	24.71	37,949	18.17
Other bonds, notes and debentures:						
Held to maturity	54	0.02	78	0.04	101	0.05
Available for sale	49,514	18.33	20,608	9.56	12,976	6.21
Total bonds, notes and debentures	256,540	94.96	202,091	93.71	197,096	94.36
Financial institution securities - Available for sale	10,802	4.00	13,191	6.12	11,779	5.64
Other equity securities - Available for sale	2,809	1.04	366	0.17		
Total equity securities	13,611	5.04	13,557	6.29	11,779	5.64
Total	$ 270,151	100.00%	$ 215,648	100.00%	$ 208,875	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, 2011:

(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	$	$	$	$	$
Yield					
AFS Amount			1,999	24,756	26,755
Yield			3.27%	5.27%	5.12%
State and political subdivisions (tax-exempt):					
HTM Amount					
Yield					
AFS Amount		1,218	2,653	123,193	127,064
Yield		2.76%	5.27%	6.56%	6.50%
State and political subdivisions (taxable):					
HTM Amount					
Yield					
AFS Amount		1,951	3,447	42,328	47,726
Yield		3.31%	5.06%	6.11%	5.92%
Other bonds, notes and debentures:					
HTM Amount	54				54
Yield	6.11%				6.11%
AFS Amount	10,239	25,936	14,076	1,196	51,447
Yield	4.18%	2.73%	3.62%	6.81%	3.36%
Total Amount	$ 10,293	$ 29,105	$ 22,175	$ 191,473	253,046
Total Yield	4.19%	2.77%	4.01%	6.30%	5.61%
Equity Securities					$ 12,690
Total Investment Portfolio Value					$ 265,736
Total Investment Portfolio Yield					5.34%

All yields represent weighted average yields expressed on a tax equivalent basis. They are calculated on the basis of the cost, adjusted for amortization of premium and accretion of discount, and effective yields weighted for the scheduled maturity of each security. The taxable equivalent adjustment represents the difference between annual income from tax-exempt obligations and the taxable equivalent of such income at the standard 34% tax rate (derived by dividing tax-exempt interest by 66%).

The distribution of credit ratings by amortized cost and estimated fair value for the debt security portfolio at December 31, 2011 follows:

	A- to AAA		B- to BBB+		C to CCC+		Not Rated		Total	
(In Thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale (AFS)										
U.S. Government and agency securities	$ 26,755	$ 28,671	$	$	$	$	$	$	$ 26,755	$ 28,671
State and political securities	158,053	162,917	6,983	6,000			9,754	9,384	174,790	178,301

Other debt securities	50,872	48,982	575	532					51,447	49,514
Total debt securities AFS	$ 235,680	$ 240,570	$ 7,558	$ 6,532	$	$	$ 9,754	$ 9,384	$ 252,992	$ 256,486
Held to maturity (HTM)										
U.S. Government and agency securities	$	$	$	$	$	$	$	$	$	$
Other debt securities	54	55							54	55
Total debt securities HTM	$ 54	$ 55	$	$	$	$	$	$	$ 54	$ 55

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LOAN PORTFOLIO

2011

Gross loans of $435,959,000 at December 31, 2011 represented an increase of $20,402,000 from December 31, 2010. The continued emphasis on well collateralized real estate loans accounted for the majority of the overall increase in loans outstanding. The success in carrying out this long term strategy played a significant role in limiting net charge-offs for 2011 to 0.37% of average loans. Successful campaigns to increase home equity and auto loans were undertaken during 2011 with the increase in residential and installment loans to individuals being directly correlated to the campaigns.

2010

Gross loans of $415,557,000 at December 31, 2010 represented an increase of $10,028,000 from December 31, 2009. The continued emphasis on well collateralized real estate loans resulted in commercial real estate secured loans increasing $8,108,000 from December 31, 2009 to 2010. The success in carrying out this long term strategy played a significant role in limiting net charge-offs for 2010 to 0.19% of average loans. The composition of the portfolio has continued to shift toward commercial from residential. This shift is the by-product of the majority of residential mortgages being sold into the secondary market versus being added to the loan portfolio.

The amounts of loans outstanding at the indicated dates are shown in the following table according to type of loan at December 31, 2011, 2010, 2009, 2008, and 2007:

	2011		2010		2009		2008		2007	
(In Thousands)	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**% Total**
Commercial and agricultural	$ 53,129	12.19%	$ 50,853	12.23%	$ 46,647	11.50%	$ 40,602	10.64%	$ 35,739	9.91%
Real estate mortgage:										
Residential	179,383	41.15	173,578	41.77	174,346	43.00	177,406	46.51	163,268	45.30
Commercial	164,288	37.68	160,189	38.55	152,209	37.53	136,158	35.69	132,943	36.88
Construction	29,457	6.76	22,545	5.43	21,795	5.37	15,838	4.16	16,152	4.48
Installment loans to individuals	11,297	2.59	9,432	2.27	11,549	2.85	12,487	3.27	13,317	3.69
Less: Net deferred loan fees and discounts	1,595	(0.37)	1,040	(0.25)	1,017	(0.25)	1,013	(0.27)	941	(0.26)
Gross loans	$ 435,959	100.00%	$ 415,557	100.00%	$ 405,529	100.00%	$ 381,478	100.00%	$ 360,478	100.00%

The amounts of domestic loans at December 31, 2011 are presented below by category and maturity:

(In Thousands)	Commercial and Agricultural	Residential	Real Estate Commercial	Construction	Installment Loans to Individuals	Total

Loans with floating interest rates:						
1 year or less	$ 8,104	$ 7,889	$ 10,573	$ 1,988	$ 1,622	$ 30,176
1 through 5 years	2,091	3,066	6,094	9,315	23	20,589
5 through 10 years	2,760	10,804	14,819	180	10	28,573
After 10 years	13,104	131,774	120,835	10,851	1,063	277,627
Total floating interest rate loans	26,059	153,533	152,321	22,334	2,718	356,965
Loans with predetermined interest rates:						
1 year or less	2,729	1,770	373	1,324	1,100	7,296
1 through 5 years	14,216	10,920	1,604	2,574	7,168	36,482
5 through 10 years	3,701	11,840	2,168		216	17,925
After 10 years	6,424	1,320	7,822	3,225	95	18,886
Total predetermined interest rate loans	27,070	25,850	11,967	7,123	8,579	80,589
Total	$ 53,129	$ 179,383	$ 164,288	$ 29,457	$ 11,297	437,554
Less: Net deferred loan fees						1,595
						$ 435,959

- The loan maturity information is based upon original loan terms and is not adjusted for rollovers. In the ordinary course of business, loans maturing within one year may be renewed, in whole or in part, at interest rates prevailing at the date of renewal.

- Scheduled repayments are reported in maturity categories in which the payment is due.

The Bank does not make loans that provide for negative amortization nor do any loans contain conversion features. The Bank does not have any foreign loans outstanding at December 31, 2011.

ALLOWANCE FOR LOAN LOSSES

2011

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio, as of the consolidated balance sheet date. All loan losses are charged to the allowance and all recoveries are credited to it per the allowance method of providing for loan losses. The allowance for loan losses is established through a provision for loan losses charged to operations. The provision for loan losses is based upon management s quarterly review of the loan portfolio. The

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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.

The allowance for loan losses increased from $6,035,000 at December 31, 2010 to $7,154,000 at December 31, 2011. At December 31, 2011, the allowance for loan losses was 1.64% of total loans compared to 1.45% of total loans at December 31, 2010. This percentage is higher than the Bank s historical experience. Management s conclusion is that the allowance for loan losses is adequate to provide for probable losses inherent in its loan portfolio as of the balance sheet date as noted in the Provision for Loan Losses discussion.

Based on management s loan-by-loan review, the past performance of the borrowers, and current economic conditions, including recent business closures and bankruptcy levels, management does not anticipate any current losses related to nonaccrual, nonperforming, or classified loans above those that have already been considered in its overall judgment of the adequacy of the allowance for loan losses.

2010

The allowance for loan losses increased from $4,657,000 at December 31, 2009 to $6,035,000 at December 31, 2010. At December 31, 2010, the allowance for loan losses was 1.45% of total loans compared to 1.15% of total loans at December 31, 2009. This percentage is consistent with peer banks and higher than the Bank s historical experience. Management s conclusion is that the allowance for loan losses is adequate to provide for probable losses inherent in its loan portfolio as of the balance sheet date as noted in the Provision for Loan Losses discussion.

Allocation of the Allowance For Loan Losses

(In Thousands)		**Amount**	**Percent of Loans in Each Category to Total Loans**
December 31, 2011:			
Balance at end of period applicable to:			
Commercial and agricultural	$	430	12.14%
Real estate mortgage:			
Residential		964	41.00
Commercial		2,719	37.55
Construction		2,846	6.73
Installment loans to individuals		195	2.58
Unallocated			
Total	$	7,154	100.00%

December 31, 2010:			
Balance at end of period applicable to:			
Commercial and agricultural	$	466	12.21%
Real estate mortgage:			
Residential		980	41.67
Commercial		1,508	38.45
Construction		2,893	5.41
Installment loans to individuals		188	2.26
Unallocated			
Total	$	6,035	100.00%
December 31, 2009:			
Balance at end of period applicable to:			
Commercial and agricultural	$	569	11.48%
Real estate mortgage:			
Residential		972	42.88
Commercial		1,491	37.44
Construction		1,403	5.36
Installment loans to individuals		222	2.84
Unallocated			
Total	$	4,657	100.00%
December 31, 2008:			
Balance at end of period applicable to:			
Commercial and agricultural	$	580	10.62%
Real estate mortgage:			
Residential		659	46.38
Commercial		1,326	35.60
Construction		1,471	4.14
Installment loans to individuals		250	3.26
Unallocated		70	
Total	$	4,356	100.00%
December 31, 2007:			
Balance at end of period applicable to:			
Commercial and agricultural	$	823	9.89%
Real estate mortgage:			
Residential		1,031	45.18
Commercial		1,634	36.78
Construction		112	4.47
Installment loans to individuals		228	3.68
Unallocated		302	
Total	$	4,130	100.00%

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NONPERFORMING LOANS

Nonaccrual loans increased as several commercial real estate relationships deteriorated in quality over the past year. These loans are primarily development loans and have a specific allowance within the allowance for loan losses.

The following table presents information concerning nonperforming loans. The accrual of interest will be discontinued when the principal or interest of a loan is in default for 90 days or more, or as soon as payment is questionable, unless the loan is well secured and in the process of collection. Consumer loans and residential real estate loans secured by 1 to 4 family dwellings are not ordinarily subject to those guidelines. The reversal of previously accrued but uncollected interest applicable to any loan placed in a nonaccrual status and the treatment of subsequent payments of either principal or interest will be handled in accordance with GAAP. These principles do not require a write-off of previously accrued interest if principal and interest are ultimately protected by sound collateral values. A nonperforming loan may be restored to accruing status when:

1. Principal and interest is no longer due and unpaid;
2. It becomes well secured and in the process of collection; and
3. Prospects for future contractual payments are no longer in doubt.

	Total Nonperforming Loans		
(In Thousands)	**Nonaccrual**	**90 Days Past Due**	**Total**
2011	$ 11,625	$ 384	$ 12,009
2010	5,658	557	6,215
2009	1,891	2,565	4,456
2008	1,476	259	1,735
2007	955	365	1,320

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The level of nonaccruing loans continues to fluctuate annually and is attributed to the various economic factors experienced both regionally and nationally. Overall, the portfolio is well secured with a majority of the balance making regular payments or scheduled to be satisfied in the near future. Presently, there are no significant amounts of loans where serious doubts exist as to the ability of the borrower to comply with the current loan payment terms which are not included in the nonperforming categories as indicated above.

Management s judgment in determining the amount of the additions to the allowance charged to operating expense considers the following factors with no single factor being determinative:

1. Economic conditions and the impact on the loan portfolio.
2. Analysis of past loan charge-offs experienced by category and comparison to outstanding loans.
3. Effect of problem loans on overall portfolio quality.
4. Reports of examination of the loan portfolio by the Pennsylvania State Department of Banking and the FDIC.

DEPOSITS

2011 vs. 2010

Total average deposits increased $37,344,000 or 7.15% from 2010 to 2011. The growth is a result of an emphasis to increase and solidify deposit relationships by focusing on core deposits, not time deposits. In fact, average core deposits, which exclude time deposits, increased $66,282,000 or 21.12%, while time deposits decreased $28,938,000 or 13.89% from 2010 to 2011. In addition to the emphasis on growing core deposits by utilizing marketing strategies, the core deposit growth is receiving a lift from the natural gas exploration throughout our market footprint and municipal account gathering efforts. In addition, the Bank has continued to capitalize on its reputation of safety and soundness during this prolonged economic downturn.

2010 vs. 2009

Total average deposits were $522,101,000 for 2010, an increase of $45,907,000 or 9.64% from 2009. Core deposits, which exclude time deposits, increased due to growth in average money market accounts of $37,206,000 or 59.15%. This core deposit growth is the result of the impact of natural gas exploration throughout our market footprint, shift in marketing strategies, and municipal account gathering efforts. Time deposits decreased due to the reasons noted previously that resulted in a reduced need for higher cost time deposit accounts. In addition, the Bank has continued to capitalize on its reputation of safety and soundness during this prolonged economic downturn.

The average amount and the average rate paid on deposits are summarized below for the years ended December 31, 2011, 2010, and 2009:

	2011		2010		2009	
(In Thousands)	Average Amount	Rate	Average Amount	Rate	Average Amount	Rate
Noninterest-bearing	$ 99,917	0.00%	$ 84,158	0.00%	$ 74,618	0.00%
Savings	70,178	0.17	64,477	0.28	60,815	0.51
Super Now	88,556	0.53	65,080	0.59	58,591	0.87
Money Market	121,458	0.88	100,112	1.17	62,906	1.95
Time	179,336	1.62	208,274	2.07	219,264	2.84
Total average deposits	$ 559,445	0.82%	$ 522,101	1.16%	$ 476,194	1.74%

SHAREHOLDERS EQUITY

2011

Shareholders equity increased $13,840,000 to $80,460,000 at December 31, 2011 compared to December 31, 2010. The accumulated other comprehensive loss of $1,219,000 at December 31, 2011 is a result of an increase in unrealized gains on available for sale securities from an unrealized loss of $7,276,000 at December 31, 2010 to an unrealized gain of $2,914,000 at December 31, 2011. However, the level of accumulated other comprehensive loss at December 31, 2011 was also impacted by the change in net excess of the projected benefit obligation over the market value of the plan assets of the defined benefit pension plan resulting in an increase in the net loss of $1,720,000. The current level of shareholders equity equates to a book value per share of $20.97 at December 31, 2011 compared to $17.37 at December 31, 2010 and an equity to asset ratio of 10.53% at December 31, 2011 compared to 9.63% at December 31, 2010. Excluding accumulated other comprehensive loss, book value per share was $21.29 at December 31, 2011 compared to

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$19.90 at December 31, 2010. Dividends paid to shareholders were $1.84 for each of the twelve months ended December 31, 2011 and 2010.

2010

Shareholders equity decreased $296,000 to $66,620,000 at December 31, 2010 compared to December 31, 2009 as accumulated other comprehensive loss increased to $9,689,000. The increase in accumulated other comprehensive loss is primarily a result of a change in unrealized losses on available for sale securities from an unrealized loss of $3,569,000 at December 31, 2009 to an unrealized loss of $7,276,000 at December 31, 2010. The other component in the increase of accumulated other comprehensive loss is an increase of $493,000 in the net excess of the projected benefit obligation over the market value of the plan assets of the defined benefit pension plan. The current level of shareholders equity equates to a book value per share of $17.37 at December 31, 2010 compared to $17.45 at December 31, 2009 and an equity to asset ratio of 9.63% at December 31, 2010. Book value per share, excluding accumulated other comprehensive loss, was $19.90 at December 31, 2010 compared to $18.88 at December 31, 2009. Dividends paid to shareholders were $1.84 for each of the twelve months ended December 31, 2010 and 2009.

Bank regulators have risk based capital guidelines. Under these guidelines the Company and Bank are required to maintain minimum ratios of core capital and total qualifying capital as a percentage of risk weighted assets and certain off-balance sheet items. At December 31, 2011, both the Company s and Bank s required ratios were well above the minimum ratios as follows:

	Company	Bank	Minimum Standards
Tier 1 capital ratio	9.57%	8.24%	4.00%
Total capital ratio	15.27%	13.32%	8.00%

For a more comprehensive discussion of these requirements, see Regulations and Supervision in Item 1 of the Annual Report on Form 10-K. Management believes that the Company will continue to exceed regulatory capital requirements.

RETURN ON EQUITY AND ASSETS

The ratio of net income to average total assets and average shareholders equity, and other certain equity ratios are presented as follows:

	2011	2010	2009
Percentage of net income to:			
Average total assets	1.69%	1.56%	0.92%
Average shareholders equity	16.60%	15.30%	9.66%
Percentage of dividends declared to net income	57.10%	64.56%	115.74%
Percentage of average shareholders equity to average total assets	10.18%	10.19%	9.50%

LIQUIDITY, INTEREST RATE SENSITIVITY, AND MARKET RISK

The asset/liability committee addresses the liquidity needs of the Company to ensure that sufficient funds are available to meet credit demands and deposit withdrawals as well as to the placement of available funds in the investment portfolio. In assessing liquidity requirements, equal consideration is given to the current position as well as the future outlook.

The following liquidity measures are monitored for compliance and were within the limits cited at December 31, 2011:

1. Net Loans to Total Assets, 85% maximum
2. Net Loans to Total Deposits, 100% maximum
3. Cumulative 90 day Maturity GAP %, +/- 20% maximum
4. Cumulative 1 Year Maturity GAP %, +/- 25% maximum

Fundamental objectives of the Company s asset/liability management process are to maintain adequate liquidity while minimizing interest rate risk. The maintenance of adequate liquidity provides the Company with the ability to meet its financial obligations to depositors, loan customers, and shareholders. Additionally, it provides funds for normal operating expenditures and business opportunities as they arise. The objective of interest rate sensitivity management is to increase net interest income by managing interest sensitive assets and liabilities in such a way that they can be repriced in response to changes in market interest rates.

The Company, like other financial institutions, must have sufficient funds available to meet its liquidity needs for deposit withdrawals, loan commitments, and expenses. In order to control cash flow, the Bank estimates future flows of cash from deposits and loan payments. The primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities, as well as FHLB borrowings. Funds generated are used principally to fund loans and purchase investment securities. Management believes the Company has adequate resources to meet its normal funding requirements.

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Management monitors the Company s liquidity on both a long and short-term basis, thereby, providing management necessary information to react to current balance sheet trends. Cash flow needs are assessed and sources of funds are determined. Funding strategies consider both customer needs and economical cost. Both short and long term funding needs are addressed by maturities and sales of available for sale investment securities, loan repayments and maturities, and liquidating money market investments such as federal funds sold. The use of these resources, in conjunction with access to credit, provides core ingredients to satisfy depositor, borrower, and creditor needs.

Management monitors and determines the desirable level of liquidity. Consideration is given to loan demand, investment opportunities, deposit pricing and growth potential, as well as the current cost of borrowing funds. The Company has a current borrowing capacity at the FHLB of $212,068,000 with $77,723,000 utilized, leaving $127,390,000 available. In addition to this credit arrangement, the Company has additional lines of credit with correspondent banks of $27,554,000. The Company s management believes that it has sufficient liquidity to satisfy estimated short-term and long-term funding needs.

Interest rate sensitivity, which is closely related to liquidity management, is a function of the repricing characteristics of the Company s portfolio of assets and liabilities. Asset/liability management strives to match maturities and rates between loan and investment security assets with the deposit liabilities and borrowings that fund them. Successful asset/liability management results in a balance sheet structure which can cope effectively with market rate fluctuations. The matching process is affected by segmenting both assets and liabilities into future time periods (usually 12 months, or less) based upon when repricing can be effected. Repriceable assets are subtracted from repriceable liabilities, for a specific time period to determine the gap , or difference. Once known, the gap is managed based on predictions about future market interest rates. Intentional mismatching, or gapping, can enhance net interest income if market rates move as predicted. However, if market rates behave in a manner contrary to predictions, net interest income will suffer. Gaps, therefore, contain an element of risk and must be prudently managed. In addition to gap management, the Company has an asset liability management policy which incorporates a market value at risk calculation which is used to determine the effects of interest rate movements on shareholders equity and a simulation analysis to monitor the effects of interest rate changes on the Company s balance sheet.

The Company currently maintains a gap position of being liability sensitive. The Company has strategically taken this position as it has decreased the duration of the time deposit portfolio over the last several years, while continuing to maintain a primarily fixed rate earning asset portfolio with a duration greater than the liabilities utilized to fund earning assets. Lengthening of the liability portfolio coupled with the addition of limited short-term assets is being undertaken. These actions are expected to reduce, but not eliminate, the liability sensitive structure of the balance sheet.

A market value at risk calculation is utilized to monitor the effects of interest rate changes on the Company s balance sheet and more specifically shareholders equity. The Company does not manage the balance sheet structure in order to maintain compliance with this calculation. The calculation serves as a guideline with greater emphasis placed on interest rate sensitivity. Changes to calculation results from period to period are reviewed as changes in results could be a signal of future events. As of the most recent analysis, the results of the market value at risk calculation were outside of established guidelines due to the strategic direction being taken.

INTEREST RATE SENSITIVITY

In this analysis the Company examines the result of various changes in market interest rates in 100 basis point increments and their effect on net interest income. It is assumed that the change is instantaneous and that all rates move in a parallel manner. Assumptions are also made concerning prepayment speeds on mortgage loans and mortgage securities.

The following is a rate shock forecast for the twelve month period ended December 31, 2012 assuming a static balance sheet as of December 31, 2011.

	Parallel Rate Shock in Basis Points						
(In Thousands)	**-200**	**-100**	**Static**	**+100**	**+200**	**+300**	**+400**
Net interest income	$ 26,876	$ 27,416	$ 27,776	$ 27,899	$ 27,981	$ 27,978	$ 27,671
Change from static	(900)	(360)		123	205	202	(105)
Percent change from static	-3.24%	-1.30%		0.44%	0.74%	0.73%	-0.38%

The model utilized to create the report presented above makes various estimates at each level of interest rate change regarding cash flow from principal repayment on loans and mortgage-backed securities and/or call activity on investment securities. Actual results could differ significantly from these estimates which would result in significant differences in the calculated projected change. In addition, the limits stated above do not necessarily represent the level of change under which management would undertake specific measures to realign its portfolio in order to reduce the projected level of change. Generally, management believes the Company is well positioned to respond expeditiously when the market interest rate outlook changes.

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INFLATION

The asset and liability structure of a financial institution is primarily monetary in nature; therefore, interest rates rather than inflation have a more significant impact on the Company s performance. Interest rates are not always affected in the same direction or magnitude as prices of other goods and services, but are reflective of fiscal policy initiatives or economic factors that are not measured by a price index.

CRITICAL ACCOUNTING POLICIES

The Company s accounting policies are integral to understanding the results reported. The accounting policies are described in detail in Note 1 of the Notes to Consolidated Financial Statements. Our most complex accounting policies require management s judgment to ascertain the valuation of assets, liabilities, commitments, and contingencies. We have established detailed policies and control procedures that are intended to ensure valuation methods are well controlled and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. The following is a brief description of our current accounting policies involving significant management valuation judgments.

Other Than Temporary Impairment of Debt and Equity Securities

Debt and equity securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reason underlying the decline, to determine whether the loss in value is other than temporary. The term other than temporary is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. For a full discussion of the Company s methodology of assessing impairment, refer to Note 3 of the Notes to Consolidated Financial Statements.

Allowance for Loan Losses

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The Company s allowance for loan losses provides for probable losses based upon evaluations of known and inherent risks in the loan portfolio.

Management uses historical information to assess the adequacy of the allowance for loan losses as well as the prevailing business environment; as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the Company s methodology of assessing the adequacy of the reserve for allowance for loan losses, refer to Note 1 of the Notes to Consolidated Financial Statements.

Goodwill and Other Intangible Assets

As discussed in Note 7 of the Notes to Consolidated Financial Statements, the Company must assess goodwill and other intangible assets each year for impairment. This assessment involves estimating cash flows for future periods. If the future cash flows were less than the recorded goodwill and other intangible assets balances, we would be required to take a charge against earnings to write down the assets to the lower value.

Deferred Tax Assets

Management uses an estimate of future earnings to support their position that the benefit of their deferred tax assets will be realized. If future income should prove non-existent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and the Company s net income will be reduced. The Company s deferred tax assets are described further in Note 11 of the Notes to Consolidated Financial Statements.

Pension Benefits

Pension costs and liabilities are dependent on assumptions used in calculating such amounts. These assumptions include discount rates, benefits earned, interest costs, expected return on plan assets, mortality rates, and other factors. In accordance with GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation of future periods. While management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect the Company s pension obligations and future expense. Our pension benefits are described further in Note 12 of the Notes to Consolidated Financial Statements.

CONTRACTUAL OBLIGATIONS

The Company has various financial obligations, including contractual obligations which may require future cash payments. The following table presents, as of December 31, 2011, significant fixed and determinable contractual obligations to third parties by payment date. Further discussion of the nature of each obligation is included in the Notes to Consolidated Financial Statements.

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(In Thousands)	One Year or Less	One to Three Years	Payments Due In Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	$ 409,143	$	$	$	$ 409,143
Time deposits	99,913	62,888	8,139	1,581	172,521
Repurchase agreements	13,153				13,153
Short-term borrowings, FHLB	16,445				16,445
Long-term borrowings, FHLB	15,000	5,528	10,750	30,000	61,278
Operating leases	422	659	494	1,303	2,878
Defined benefit pension obligations	563	1,167	1,260	4,055	7,045
	$ 554,639	$ 70,242	$ 20,643	$ 36,939	$ 682,463

The Company s operating lease obligations represent short and long-term lease and rental payments for branch facilities. The Bank leases certain facilities under operating leases which expire on various dates through 2024. Renewal options are available on the majority of these leases.

CAUTIONARY STATEMENT FOR PURPOSES OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Report contains certain forward-looking statements including statements concerning plans, objectives, future events or performance and assumptions and other statements which are other than statements of historical fact. The Company wishes to caution readers that the following important factors, among others, may have affected and could in the future affect the Company s actual results and could cause the Company s actual results for subsequent periods to differ materially from those expressed in any forward-looking statement made by or on behalf of the Company herein: (i) the effect of changes in laws and regulations, including federal and state banking laws and regulations, with which the Company must comply, and the associated costs of compliance with such laws and regulations either currently or in the future as applicable; (ii) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as by the Financial Accounting Standards Board, or of changes in the Company s organization, compensation and benefit plans; (iii) the effect on the Company s competitive position within its market area of the increasing consolidation within the banking and financial services industries, including the increased competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services; (iv) the effect of changes in interest rates; and (v) the effect of changes in the business cycle and downturns in the local, regional or national economies.

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ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk for the Company is comprised primarily from interest rate risk exposure and liquidity risk. Interest rate risk and liquidity risk management is performed at the Bank level as well as the Company level. The Company s interest rate sensitivity is monitored by management through selected interest rate risk measures produced internally. Additional information and details are provided in the Interest Sensitivity section of Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

Generally, management believes the Company is well positioned to respond expeditiously when the market interest rate outlook changes.

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Penns Woods Bancorp, Inc.

We have audited the accompanying consolidated balance sheet of Penns Woods Bancorp, Inc. (the Company) and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, shareholders equity, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s and subsidiaries internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 13, 2012, expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

Wexford, PA

March 13, 2012

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PENNS WOODS BANCORP, INC.

CONSOLIDATED BALANCE SHEET

(In Thousands, Except Share Data)	**December 31, 2011**	**2010**
ASSETS:		
Noninterest-bearing balances	$ 13,829	$ 9,467
Interest-bearing deposits in other financial institutions	56	26
Total cash and cash equivalents	13,885	9,493
Investment securities, available for sale, at fair value	270,097	215,565
Investment securities, held to maturity, (fair value of $55 and $83)	54	83
Loans held for sale	3,787	6,658
Loans	435,959	415,557
Less: Allowance for loan losses	7,154	6,035
Loans, net	428,805	409,522
Premises and equipment, net	7,707	7,658
Accrued interest receivable	3,905	3,765
Bank-owned life insurance	16,065	15,436
Investment in limited partnerships	3,544	4,205
Goodwill	3,032	3,032
Deferred tax asset	7,991	11,897
Other assets	5,081	4,374
TOTAL ASSETS	$ 763,953	$ 691,688
LIABILITIES:		
Interest-bearing deposits	$ 470,310	$ 428,161
Noninterest-bearing deposits	111,354	89,347
Total deposits	581,664	517,508
Short-term borrowings	29,598	27,299
Long-term borrowings, Federal Home Loan Bank (FHLB)	61,278	71,778
Accrued interest payable	536	750
Other liabilities	10,417	7,733
TOTAL LIABILITIES	683,493	625,068
SHAREHOLDERS EQUITY:		
Common stock, par value $8.33, 10,000,000 shares authorized; 4,017,677 and 4,015,753 shares issued	33,480	33,464
Additional paid-in capital	18,115	18,064
Retained earnings	36,394	31,091
Accumulated other comprehensive loss:		
Net unrealized gain (loss) on available for sale securities	2,914	(7,276)
Defined benefit plan	(4,133)	(2,413)
Less: Treasury stock at cost, 180,596 shares	(6,310)	(6,310)
TOTAL SHAREHOLDERS EQUITY	80,460	66,620
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 763,953	$ 691,688

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.

CONSOLIDATED STATEMENT OF INCOME

	Year Ended December 31,		
(In Thousands, Except Per Share Data)	**2011**	**2010**	**2009**
INTEREST AND DIVIDEND INCOME:			
Loans, including fees	$ 25,187	$ 25,513	$ 25,568
Investment securities:			
Taxable	5,677	5,584	5,424
Tax-exempt	5,260	5,059	5,005
Dividend and other interest income	252	206	194
TOTAL INTEREST AND DIVIDEND INCOME	36,376	36,362	36,191
INTEREST EXPENSE:			
Deposits	4,566	6,055	8,284
Short-term borrowings	202	265	396
Long-term borrowings, FHLB	2,888	3,548	3,718
TOTAL INTEREST EXPENSE	7,656	9,868	12,398
NET INTEREST INCOME	28,720	26,494	23,793
PROVISION FOR LOAN LOSSES	2,700	2,150	917
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	26,020	24,344	22,876
NON-INTEREST INCOME:			
Service charges	2,021	2,177	2,200
Securities gains (losses), net	621	173	(4,846)
Earnings on bank-owned life insurance	599	636	713
Gain on sale of loans	1,130	949	826
Insurance commissions	933	970	1,189
Brokerage commissions	997	965	768
Other	1,918	1,589	1,437
TOTAL NON-INTEREST INCOME	8,219	7,459	2,287
NON-INTEREST EXPENSE:			
Salaries and employee benefits	10,479	10,214	10,189
Occupancy, net	1,262	1,240	1,266
Furniture and equipment	1,379	1,264	1,212
Pennsylvania shares tax	689	677	685
Amortization of investment in limited partnerships	661	693	567
FDIC deposit insurance	525	737	1,067