UNIFI INC
Form S-3
February 09, 2007
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**As filed with the Securities and Exchange Commission on February 9, 2007**

**Registration No. 333-**

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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM S-3

# REGISTRATION STATEMENT

***UNDER***

***THE SECURITIES ACT OF 1933***

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# UNIFI, INC.

**(Exact name of Registrant as specified in its charter)**

| **New York** | **11-2165495** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(IRS Employer Identification No.)** |

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**P.O. Box 19109**

**7201 West Friendly Avenue**

**Greensboro, NC 27410**

**(336) 294-4410**

**(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)**

**Charles F. McCoy, Esq.**

**P.O. Box 19109**

**7201 West Friendly Avenue**

**Greensboro, NC 27410**

**(336) 294-4410**

**(Name, address, including zip code, and telephone number, including area code, of agent for service)**

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***Copies to:***

**Lawrence G. Wee, Esq.**

**Paul, Weiss, Rifkind, Wharton & Garrison LLP**

**1285 Avenue of the Americas**

**New York, NY 10019-6064**

**(212) 373-3000**

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**Approximate date of commencement of proposed sale to public:** From time to time after this Registration Statement becomes effective.

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If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. ¨

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 of the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box. ¨

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box. ¨

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**CALCULATION OF REGISTRATION FEE**

| Title of Each Class of Securities to be Registered | Amount to be Registered(2) | Proposed Maximum Offering Price Per Unit(1) | Proposed Maximum Aggregate Offering Price(1) | Amount of Registration Fee |
|---|---|---|---|---|
| Common Stock, par value $.10 per share | 8,333,333 | $ 2.90 | $ 24,166,666 | $ 2,586 |

(1) Estimated solely for the purpose of calculating the registration fee in accordance with Rule 457(c) under the Securities Act of 1933. The offering price and registration fee are computed using $2.90, the average of the high and low prices of the registrant s common stock, as reported by The New York Stock Exchange on February 6, 2007.

(2) Pursuant to Rule 416 under the Securities Act of 1933, this registration statement shall be deemed to cover any additional securities to be offered or issued from stock splits, stock dividends, recapitalizations or similar transactions.

**The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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**The information in this prospectus is not complete and may be changed. The selling shareholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED FEBRUARY 9, 2007**

**PRELIMINARY PROSPECTUS**

# UNIFI, INC.

## 8,333,333 Shares

## Common Stock

This prospectus relates to the resale of 8,333,333 shares of our common stock that may be offered for sale from time to time by the selling shareholders named in this prospectus. The shares of common stock offered under this prospectus were issued to the selling shareholders in connection with our acquisition of certain textured polyester and nylon yarn manufacturing assets of Dillon Yarn Corporation on January 1, 2007. We will not receive any of the proceeds from the shares of common stock sold by the selling shareholders.

The shares of common stock offered under this prospectus may be sold at fixed prices, prevailing market prices at the times of sale, prices related to the prevailing market prices, varying prices determined at the times of sale or negotiated prices. The shares of common stock offered by this prospectus and any prospectus supplement may be offered by the selling shareholders directly to investors or to or through underwriters, dealers or other agents. If required, the names of any such agents, underwriters, brokers or dealers involved in the sale of the shares in respect of which this prospectus is being delivered and the applicable agent s commission, broker s or dealer s purchase price or underwriters discount, if any, will be set forth in an accompanying supplement to this prospectus.

We will bear all expenses of this offering of our common stock, other than selling expenses of the selling shareholders (including all underwriting discounts and commissions, if any), fees and expenses of the selling shareholders counsel, any stock transfer taxes in connection with any underwritten offering and all registration expenses to the extent required by applicable law.

Our common stock is traded on the New York Stock Exchange under the symbol UFI.

On February 8, 2007, the last reported sale price of our common stock was $2.89.

**Investing in our common stock involves risks. See Risk Factors beginning on page 4 of this prospectus.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

The date of this prospectus is , 2007.

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**You should rely only on the information contained in or incorporated by reference in this prospectus. Neither the selling shareholders nor we have authorized anyone to provide you with information that is different. The information in this prospectus or the information we previously filed with the Securities and Exchange Commission, or the SEC, that we incorporate by reference in this prospectus may only be accurate as of its respective date.**

## WHERE YOU CAN FIND MORE INFORMATION

We have filed a registration statement on Form S-3 with the SEC regarding the common stock offered by this prospectus. This prospectus, which forms part of the registration statement, does not contain all of the information included in the registration statement and the exhibits to the registration statement, because certain parts have been omitted in accordance with the rules and regulations of the SEC. For further information about us and our common stock offered by this prospectus, you should refer to the registration statement and the exhibits filed as part of the registration statement and the documents incorporated by reference.

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any materials that we file with the SEC at the SEC Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. Our SEC filings can also be read at the New York Stock Exchange, 20 Broad Street, New York, New York 10005. The SEC maintains an Internet site that contains the reports, proxy and information statements and other information that we and other issuers file electronically with the SEC. The SEC s Internet web site address is http://www.sec.gov.

Our common stock is listed on the New York Stock Exchange under the symbol UFI.

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## INCORPORATION OF DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference into this prospectus the information we file with the SEC. This means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this prospectus. If we subsequently file updating or superseding information in a document that is incorporated by reference into this prospectus, the subsequent information will also become part of this prospectus and will supersede the earlier information.

We are incorporating by reference the following documents that we have filed with the SEC:

- our Annual Report on Form 10-K for the year ended June 25, 2006, as filed with the SEC on September 8, 2006, including the information incorporated by reference from our Proxy Statement filed with the SEC on September 26, 2006 in connection with the solicitation of proxies for the Annual Meeting of Shareholders of Unifi, Inc. held on October 25, 2006;

- our Quarterly Reports on Form 10-Q for the quarters ended September 24, 2006 and December 24, 2006, as filed with the SEC on November 3, 2006 and February 2, 2007, respectively;

- our Current Reports on Form 8-K filed on July 31, 2006, October 26, 2006 (with respect to Items 1.01 and 8.01 only), October 31, 2006, December 8, 2006, January 4, 2007 and January 30, 2007; and

- the description of our common stock contained in our registration statement on Form 8-A, filed with the SEC on October 29, 1973, including any amendments or reports filed for the purpose of updating such description.

We are also incorporating by reference into the accompanying prospectus all of our future filings with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 until this offering has been completed.

You may request a copy of these filings at no cost, by writing or telephoning us at the following address:

Mr. Charles F. McCoy

General Counsel

Unifi, Inc.

P.O. Box 19109

Greensboro, NC 27419-9109

(336) 294-4410

**Except as expressly provided above, no other information, including information on our web site, is incorporated by reference into this prospectus.**

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## PROSPECTUS SUMMARY

*This summary highlights certain information concerning our business. It does not contain all of the information that may be important to you and to your investment decision. The following summary is qualified in its entirety by the more detailed information appearing elsewhere or incorporated by reference in this prospectus. You should carefully read the entire prospectus and the information incorporated by reference in this prospectus, and should consider, among other things, the matters set forth under Risk Factors before making an investment decision.*

*Unless otherwise specified or the context requires otherwise, reference in this prospectus to the Company or Unifi or we, us, or our refers to Unifi, Inc. and its direct and indirect subsidiaries on a consolidated basis.*

### Our Company

We are a diversified North American producer and processor of multi-filament polyester and nylon yarns, including specialty yarns with enhanced performance characteristics. We add value to the supply chain and enhance consumer demand for our products through the development and introduction of branded yarns that provide unique performance, comfort and aesthetic advantages. We manufacture partially oriented, textured, dyed, twisted and beamed polyester yarns as well as textured nylon and nylon covered spandex products. We sell our products to other yarn manufacturers, knitters and weavers that produce fabrics for the apparel, hosiery, home furnishings, automotive, industrial and other end-use markets. We maintain one of the industry s most comprehensive product offerings and emphasize quality, style and performance in all of our products.

We work across the supply chain to develop and commercialize specialty yarns that provide performance, comfort, aesthetic and other advantages that enhance demand for our products. We have branded the premium portion of our specialty value-added yarns, which we refer to as premium value-added yarns, in order to distinguish our products in the marketplace. We currently have more than 20 premium value-added yarns in our portfolio, which we commercialize under several brand names, including Sorbtek®, A.M.Y.®, Mynx® UV, Reflexx®, MicroVista®, aio® and Repreve®.

We use advanced production processes to manufacture our high-quality yarns cost-effectively. We believe that our flexibility and experience in producing specialty yarns provides us with important development and commercialization advantages. We have state-of-the-art manufacturing operations in North and South America and participate in joint ventures in China, Israel and the United States.

We are a corporation organized under the laws of the State of New York in 1969. Our principal offices are located at 7201 West Friendly Avenue, Greensboro, NC 27410; telephone number: (336) 294-4410. Our web site address is www.unifi.com. Our web site and the information contained on our web site are not a part of this prospectus.

### Dillon Acquisition

Effective January 1, 2007, Unifi Manufacturing, Inc., one of our wholly owned subsidiaries, completed its acquisition of specified assets and assumed specified liabilities from Dillon Yarn Corporation, a privately-held South Carolina corporation, related to or used in Dillon s textured nylon and polyester yarn businesses. The Dillon acquisition was completed under the Asset Purchase Agreement between Unifi Manufacturing and Dillon dated as of October 25, 2006, subsequently amended on January 1, 2007. The aggregate consideration paid in connection with the Dillon acquisition was approximately $62.6 million, consisting of a combination of approximately $42.0 million in cash, subject to post-closing adjustment, and 8,333,333 million shares of our common stock, valued at approximately $20.5 million, which are the shares of common stock that are being offered under this prospectus.

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Under a Registration Rights Agreement between us and Dillon dated as of January 1, 2007, we are required to file a registration statement covering the possible resale of the shares of our common stock issued to the selling shareholders and certain permitted transferees in connection with the Dillon acquisition.

All of the shares of our common stock that may be offered under this prospectus were issued by us to the selling shareholders named in this prospectus under the section entitled Selling Shareholders in connection with the Dillon acquisition. Our common stock will be offered on a continuous basis under Rule 415 of the Securities Act of 1933, subject to the restrictions contained in the Registration Rights Agreement. A provision in the Registration Rights Agreement prohibits the selling shareholders from transferring our common stock issued in connection with the Dillon acquisition prior to July 1, 2007, except to certain permitted transferees. On and after July 1, 2007 and prior to July 1, 2008, one-third of the shares, or 2,777,778 shares, may be transferred. On and after July 1, 2008 and prior to July 1, 2009, two-thirds of the shares, or 5,555,556 shares, may be transferred. All of the 8,333,333 shares may be transferred after July 1, 2009.

We have agreed to keep this shelf registration statement effective until there are no longer any Registrable Securities subject to the Registration Rights Agreement. Shares of our common stock cease to be Registrable Securities when:

- a registration statement covering such stock has been declared effective under the Securities Act by the SEC and such stock has been disposed of under that registration statement;
- the entire amount of stock owned by the holder of such stock may be sold in a single sale without any limitation as to volume under Rule 144 under the Securities Act and the holder owns less than 1.0% of the outstanding shares of our common stock on a fully diluted basis; or
- the stock is transferred to a person not eligible for registration rights under the Registration Rights Agreement.

We and the selling shareholders have agreed to indemnify each other in certain circumstances against certain liabilities, including liabilities under the Securities Act.

**Risk Factors**

Our business is subject to those risks discussed in the section entitled Risk Factors immediately following this Prospectus Summary. These risks include, but are not limited to: the competitive nature of the textile industry and the impact of worldwide competition; changes in the trade regulatory environment and governmental policies and legislation; the availability, sourcing and pricing of raw materials; general domestic and international economic and industry conditions in markets where we compete, such as recession and other economic and political factors over which we have no control; our ability to reduce production costs; changes in consumer spending, customer preferences, fashion trends and end-uses; changes in currency exchange rates, interest and inflation rates; the financial condition of our customers; technological advancements and the continued availability of financial resources to fund capital expenditures; the operating performance of joint ventures, alliances and other equity investments; our ability to integrate fully the newly-acquired Dillon operations; the impact of environmental, health and safety regulations; and employee relations.

Any of the above risks could adversely affect our financial condition and results of operations. Investment in our common stock involves risks. You should read and consider the information set forth in Risk Factors and all other information set forth in or incorporated by reference in this prospectus before investing in our common stock.

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**The Offering**

| | |
|---|---|
| Common stock that may be offered by the selling shareholders | 8,333,333 shares |
| Common stock to be outstanding after this offering | 60,541,800 shares* |
| Use of Proceeds | We will not receive any proceeds from the sale of our common stock by the selling shareholders. See Use of Proceeds. |
| Plan of Distribution | The selling shareholders may offer and sell our common stock covered by this prospectus from time to time through the NYSE, the over-the-counter market, or otherwise, directly to purchasers, or through underwriters, brokers, dealers or agents. See Plan of Distribution. |
| NYSE Symbol | UFI |

* The number of shares outstanding after this offering is based on the number of shares outstanding as of February 1, 2007.

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## RISK FACTORS

*You should carefully consider each of the following risks and all other information contained or incorporated by reference in this prospectus before making an investment decision. The risks and uncertainties described below are not the only ones we face. If any of the following risks actually occur, our business, financial condition and/or operating results could be materially adversely affected, which, in turn, could adversely affect our ability to pay dividends on our common stock and could result in a decline in the trading price of our common stock and the loss of all or part of your investment.*

### Risks Related to Our Business

***Our substantial level of indebtedness could adversely affect our financial condition.***

We have substantial indebtedness. As of December 24, 2006, we had a total of $206.1 million of debt outstanding, including $190.0 million outstanding under our 11 1/2% senior secured notes due 2014, and $1.3 million outstanding under our 6 1/2% senior unsecured notes due 2008. As of the same date, there were no amounts outstanding under our senior secured asset-based revolving credit facility.

Our outstanding indebtedness could have important consequences to you, including the following:

- the restrictions imposed on the operation of our business may hinder our ability to take advantage of strategic opportunities to grow our business;
- our ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be impaired;
- we must use a substantial portion of our cash flow from operations to pay interest on our outstanding notes and, to the extent incurred, our other indebtedness, which will reduce the funds available to us for operations and other purposes;
- our high level of indebtedness could place us at a competitive disadvantage compared to our competitors that may have proportionately less debt;
- our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate may be limited; and
- our high level of indebtedness makes us more vulnerable to economic downturns and adverse developments in our business.

Any of the foregoing could have a material adverse effect on our business, financial condition, results of operations and prospects.

***Despite our current indebtedness levels, we may still be able to incur substantially more debt. This could exacerbate further the risks associated with our substantial leverage.***

We and our subsidiaries may be able to incur substantial additional indebtedness, including additional secured indebtedness, in the future. The terms of the indentures governing our outstanding notes and our revolving credit facility restrict, but do not completely prohibit, us from doing so. Our revolving credit facility permits up to $100.0 million of borrowings, which we can request be increased to $150.0 million under certain circumstances, with a borrowing base specified in the credit facility as equal to specified percentages of eligible accounts receivable and inventory. In addition, the indenture governing our senior secured notes allows us to incur additional debt, subject to limitations specified in that indenture. The indenture governing our senior unsecured notes does not contain any restrictive covenants or limitations on indebtedness. In addition, the indentures governing our outstanding notes and our revolving credit facility do not prevent us from incurring other liabilities that do not constitute indebtedness. If new debt or other liabilities are added to our current debt levels, the related risks that we now face could intensify.

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***We will require a significant amount of cash to service our indebtedness, and our ability to generate cash depends on many factors beyond our control. As a result, after servicing our indebtedness, making capital expenditures and satisfying our other liquidity needs, our ability to pay dividends on our common stock will be limited.***

For fiscal year 2006, after giving effect to the refinancing transactions, interest expense, net, would have been approximately $17.9 million. Our principal sources of liquidity are cash flow generated from operations and borrowings under our revolving credit facility. Our ability to make payments on and to refinance our indebtedness, to fund planned capital expenditures, to satisfy our other liquidity needs and to pay dividends on our common stock will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

Our business may not generate cash flow from operations, and future borrowings may not be available to us under our revolving credit facility in an amount sufficient to enable us to pay our indebtedness and to fund our other liquidity needs. If we are not able to generate sufficient cash flow or borrow under our revolving credit facility for these purposes, we may need to refinance or restructure all or a portion of our indebtedness on or before maturity, reduce or delay capital investments, delay or eliminate dividend payments or seek to raise additional capital. We may not be able to implement one or more of these alternatives on terms acceptable to us, or at all. The terms of our existing or future debt agreements may restrict us from adopting any of these alternatives. The failure to generate sufficient cash flow or to achieve any of these alternatives could materially and adversely affect our liquidity position and the value of our common stock. In addition, without such refinancing, we could be forced to sell assets to make up for any shortfall in our payment obligations under unfavorable circumstances. The agreements governing our outstanding indebtedness limit our ability to sell assets and also restrict the use of proceeds from any such sale. We may not be able to sell our assets quickly enough or for sufficient amounts to enable us to meet our debt service obligations.

To the extent there is limited cash left after servicing our indebtedness and satisfying our other liquidity needs, we will be limited in our ability to pay dividends on our common stock.

Finally, the agreements governing our indebtedness restrict our ability to pay dividends on our common stock. See  We do not expect to pay dividends on our common stock in the foreseeable future, and, because we are a parent company, with no independent operations of our own and are subject to restrictions on our ability to pay dividends under our debt agreements, we may be unable to pay dividends on our common stock.

***The indenture governing our senior secured notes and our revolving credit facility impose significant operating and financial restrictions, which may prevent us from pursuing certain business opportunities and taking certain actions.***

The indenture governing our senior secured notes and our revolving credit facility impose significant operating and financial restrictions on us. These restrictions will limit or prohibit, among other things, our ability to:

- incur and guarantee indebtedness or issue preferred stock;
- repay subordinated indebtedness prior to its stated maturity;
- pay dividends or make other distributions on or redeem or repurchase our stock;
- issue capital stock;
- make certain investments or acquisitions;
- create liens;

- sell certain assets or merge with or into other companies;
- enter into certain transactions with shareholders and affiliates;
- make capital expenditures; and
- restrict dividends, distributions or other payments from our subsidiaries.

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In addition, our revolving credit facility also requires us to meet a minimum fixed charge ratio test if borrowing capacity is less than $25.0 million at any time during any quarter and restricts our ability to make capital expenditures or prepay certain other debt. We may not be able to maintain this ratio. These restrictions could limit our ability to plan for or react to market conditions or meet our capital needs. We may not be granted waivers or amendments to our revolving credit facility if for any reason we are unable to meet its requirements, or we may not be able to refinance our debt on terms acceptable to us, or at all.

The breach of any of these covenants or restrictions could result in a default under the indenture governing our senior secured notes or under our revolving credit facility. An event of default under the indenture governing our senior secured notes or under our revolving credit facility would permit some of our lenders to declare all amounts borrowed from them to be due and payable.

***We face intense competition from a number of domestic and foreign yarn producers and importers of textile and apparel products.***

Our industry is highly competitive. We compete not only against domestic and foreign yarn producers, but also against importers of foreign sourced fabric and apparel into the United States and other countries in which we do business. Our major regional competitors are Nan Ya Plastics Corp. of America, O Mara, Inc., Spectrum Yarns, Inc., KOSA and AKRA, S.A. de C.V. in the polyester yarn segment and Sapona Manufacturing Company, Inc., McMichael Mills, Inc. and Worldtex, Inc. in the nylon yarn segment. The importation of garments and fabrics from lower wage-based countries and overcapacity throughout the world has resulted in lower net sales, gross profits and net income for both our polyester and nylon segments. The primary competitive factors in the textile industry include price, quality, product styling and differentiation, flexibility of production and finishing, delivery time and customer service. The needs of particular customers and the characteristics of particular products determine the relative importance of these various factors. Because we, and the supply chain in which we operate, do not typically operate on the basis of long-term contracts with textile and apparel customers, these competitive factors could cause our customers to rapidly shift to other producers. A large number of our foreign competitors have significant competitive advantages over us, including lower labor costs, lower raw materials and energy costs and favorable currency exchange rates against the U.S. dollar. If any of these advantages increase, our products could become less competitive, and our sales and profits may decrease as a result. In addition, while traditionally these foreign competitors have focused on commodity production, they are now increasingly focused on value-added products, where we continue to generate higher margins. Competitive pressures may also intensify as a result of the gradual elimination of quotas and the potential elimination of duties. See Changes in the trade regulatory environment could weaken our competitive position dramatically and have a material adverse effect on our business, net sales and profitability. We, and the supply chain in which we operate, may therefore not be able to continue to compete effectively with imported foreign-made textile and apparel products, which would materially adversely affect our business, financial condition, results of operations or cash flows.

***Changes in the trade regulatory environment could weaken our competitive position dramatically and have a material adverse effect on our business, net sales and profitability.***

A number of sectors of the textile industry in which we sell our products, particularly apparel and home furnishings, are subject to intense foreign competition. Other sectors of the textile industry in which we sell our products may in the future become subject to more intense foreign competition. There are currently a number of trade regulations, quotas and duties in place to protect the U.S. textile industry against competition from low-priced foreign producers, such as China. Changes in such trade regulations, quotas and duties may make our products less attractive from a price standpoint than the goods of our competitors or the finished apparel products of a competitor in the supply chain, which could have a material adverse effect on our business, net sales and profitability. In addition, increased foreign capacity and imports that compete directly with our products could have a similar effect. Furthermore, one of our key business strategies is to expand our business within countries that are parties to free-trade agreements with the United States. Any relaxation of duties or other trade protections

with respect to countries that are not parties to those free-trade agreements could therefore decrease the importance of the trade agreements and have a material adverse effect on our business, net sales and profitability. See Item 1: Business Trade Regulation in our annual report on Form 10-K for the fiscal year ended June 25, 2006 for more information.

***The significant price volatility of many of our raw materials and rising energy costs may result in increased production costs, which we may not be able to pass on to our customers, which could have a material adverse effect on our business, financial condition, results of operations or cash flows.***

A significant portion of our raw materials are petroleum-based chemicals and a significant portion of our costs are energy costs. The prices for petroleum and petroleum-related products and energy costs are volatile and have recently increased significantly. While we frequently enter into raw material supply agreements, as is the general practice in our industry, these agreements typically provide for formula-based pricing. Therefore, our supply agreements provide only limited protection against price volatility. As a result, our production costs have increased significantly in recent times. While we have in the past matched cost increases with corresponding product price increases, we may not always be able to immediately raise product prices, and, ultimately, pass on underlying cost increases to our customers. We have in the past lost, and we expect that we will continue to lose, customers to our competitors as a result of these price increases. In addition, our competitors may be able to obtain raw materials at a lower cost than we are due to market regulations. Additional raw material and energy cost increases that we are not able to fully pass on to customers or the loss of a large number of customers to competitors as a result of price increases could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***We depend upon limited sources for raw materials, and interruptions in supply could increase our costs of production and cause our operations to suffer.***

We depend on a limited number of third parties for certain of our raw material supplies, such as polyester polymer beads, or chip, terephthalic acid, or TPA, and monoethylene glycol, or MEG. Although alternative sources of raw materials exist, we may not continue to be able to obtain adequate supplies of such materials on acceptable terms, or at all, from other sources when our existing supply agreements expire. In addition, we have in the past and may in the future experience interruptions or limitations in the supply of our raw materials, which would increase our product costs and could have a material adverse effect on our business, financial condition, results of operations or cash flows. For example, in the Louisiana area in 2005, Hurricane Katrina created shortages in the supply of paraxlyene, a feedstock used in polymer production, because refineries diverted production to mixed xylene to increase the supply of gasoline. As a result, supplies of paraxlyene were reduced, and prices increased. Additionally, five of the six refineries in Texas that produce MEG shut down, including the supplier to our Kinston operation due to Hurricane Rita. The supply of MEG was reduced, and prices increased as well. These disruptions had an adverse effect on our net sales and product costs. Any future disruption or curtailment in the supply of any of our raw materials could cause us to reduce or cease our production in general or require us to increase our pricing, which could have a material adverse effect on our business, financial condition, results of operations or cash flows. See The significant price volatility of many of our raw materials and rising energy costs may result in increased production costs, which we may not be able to pass on to our customers, which could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***A decline in general economic or political conditions and changes in consumer spending could cause our sales and profits to decline.***

Our products are used in the production of fabrics primarily for the apparel, hosiery, home furnishing, automotive, industrial and other similar end-use markets. Demand for furniture and durable goods, such as automobiles, is often affected significantly by economic conditions. Demand for a number of categories of apparel also tends to be tied to economic cycles. Domestic demand for textile products therefore tends to vary with the business cycles of the U.S. economy as well as changes in global economic and political conditions.

Future armed conflicts, terrorist activities or natural disasters in the United States or abroad and any consequent actions on the part of the U.S. government and others may cause general economic conditions in the United States to deteriorate or otherwise reduce U.S. consumer spending. A decline in general economic conditions or consumer confidence may also lead to significant changes to inventory levels and, in turn, replenishment orders placed with suppliers. These changing demands ultimately work their way through the supply chain and could adversely affect demand for our products and have a material adverse effect on our business, net sales and profitability.

***Failure to successfully reduce our production costs may adversely affect our financial results.***

A significant portion of our strategy relies upon our ability to successfully rationalize and improve the efficiency of our operations. In particular, our strategy relies on our ability to reduce our production costs in order to remain competitive. Over the past three years, we have consolidated multiple unprofitable businesses and production lines in an effort to match operating rates to the market; reduced overhead and supply costs; focused on optimizing the product mix amongst our reorganized assets; and made significant capital expenditures to more completely automate our production facilities, lessen the dependence on labor and decrease waste. If we are not able to continue to successfully implement cost reduction measures, or if these efforts do not generate the level of cost savings that we expect going forward or result in higher than expected costs, there could be a material adverse effect on our business, financial condition, results of operations or cash flows.

***Changes in customer preferences, fashion trends and end-uses could have a material adverse effect on our business, net sales and profitability and cause inventory build-up if we are not able to adapt to such changes.***

The demand for many of our products depends upon timely identification of consumer preferences for fabric designs, colors and styles. In the apparel sector, a failure by us or our customers to identify fashion trends in time to introduce products and fabrics consistent with those trends could reduce our sales and the acceptance of our products by our customers and decrease our profitability as a result of costs associated with failed product introductions and reduced sales. Our nylon segment has been adversely affected by changing customer preferences that have reduced demand for sheer hosiery products. In all sectors, changes in customer preferences or specifications may cause shifts away from products we provide, which can also have an adverse effect on our business, net sales and profitability.

***We have significant foreign operations, and our results of operations may be adversely affected by currency fluctuations.***

We have a significant operation in Brazil, operations in Colombia and joint ventures in China and Israel. We serve customers in Canada, Mexico, Israel and various countries in Europe, Central America, South America and South Africa. Foreign operations are subject to certain political, economic and other uncertainties not encountered by our domestic operations that can materially affect our sales, profits, cash flows and financial position. The risks of international operations include trade barriers, duties, exchange controls, national and regional labor strikes, social and political risks, general economic risks, required compliance with a variety of foreign laws, including tax laws, the difficulty of enforcing agreements and collecting receivables through foreign legal systems, taxes on distributions or deemed distributions to us or any of our U.S. subsidiaries, maintenance of minimum capital requirements and import and export controls. Through our foreign operations, we are also exposed to currency fluctuations and exchange rate risks. Because a significant amount of our costs incurred to generate the revenues of our foreign operations are denominated in local currencies, while the majority of our sales are in U.S. dollars, we have in the past been adversely impacted by the appreciation of the local currencies relative to the U.S. dollar, and currency exchange rate fluctuations could have a material adverse effect on our business, financial condition, results of operations or cash flows. We have translated our revenues and expenses denominated in local currencies into U.S. dollars at the average exchange rate during the relevant period and our assets and liabilities denominated in local currencies into U.S. dollars at the exchange rate at the

end of the relevant period. Fluctuations in the foreign exchange rates will affect period-to-period comparisons of our reported results. Additionally, we operate in countries with foreign exchange controls. These controls may limit our ability to repatriate funds from our international operations and joint ventures or otherwise convert local currencies into U.S. dollars. These limitations could adversely affect our ability to access cash from these operations.

***We may be exposed to liabilities under the Foreign Corrupt Practices Act, and any determination that we violated the Foreign Corrupt Practices Act could have a material adverse effect on our business.***

To the extent that we operate outside the United States, we are subject to the Foreign Corrupt Practices Act, or FCPA, which generally prohibits U.S. companies and their intermediaries from bribing foreign officials for the purpose of obtaining or keeping business or otherwise obtaining favorable treatment. In particular, we may be held liable for actions taken by our strategic or local partners even though such partners are foreign companies that are not subject to the FCPA. Any determination that we have violated the FCPA could result in sanctions that could have a material adverse effect on our business.

***Our business could be negatively impacted by the financial condition of our customers.***

The U.S. textile and apparel industry faces many challenges. Overcapacity, volatility in raw material pricing and intense pricing pressures have led to the closure of many domestic textile and apparel plants. Continued negative industry trends may result in the deteriorating financial condition of our customers. Certain of our customers are experiencing financial difficulties. Although our business is not dependent on any particular customer, the loss of any significant portion of our sales to any of these customers could have a material adverse impact on our business, results of operations, financial condition or cash flows. In addition, any receivable balances related to our customers would be at risk in the event of their bankruptcy.

As one of the many participants in the U.S. and regional textile and apparel supply chain, our business and competitive position are directly impacted by the business and financial condition of the other participants across the supply chain in which we operate, including other regional yarn manufacturers, knitters and weavers. If other supply chain participants are unable to access capital, fund their operations and make required technological and other investments in their businesses or experience diminished demand for their products, there could be a material adverse impact on our business, financial condition, results of operations or cash flows.

***Failure to implement future technological advances in the textile industry or fund capital expenditure requirements could have a material adverse effect on our competitive position and net sales.***

Our operating results depend to a significant extent on our ability to continue to introduce innovative products and applications and to continue to develop our production processes to be a competitive producer. Accordingly, to maintain our competitive position and our revenue base, we must continually modernize our manufacturing processes, plants and equipment. To this end, we have made significant investments in our manufacturing infrastructure over the past fifteen years and do not currently anticipate any significant additional capital expenditures to replace or expand our production facilities over the next five years. Accordingly, we expect our capital requirements in the near term will be used primarily to maintain our manufacturing operations, but we may nevertheless require significant capital expenditures for expansion purposes. Future technological advances in the textile industry may result in the availability of new products or increase the efficiency of existing manufacturing and distribution systems, and we may not be able to adapt to such technological changes or offer such products on a timely basis or establish or maintain competitive positions. Existing, proposed or yet undeveloped technologies may render our technology less profitable or less viable, and we may not have available the financial and other resources to compete effectively against companies possessing such technologies. To the extent sources of funds are insufficient to meet our ongoing capital improvement requirements, we would need to seek alternative sources of financing or curtail or delay capital spending plans. We may not be able to obtain the necessary financing when needed or on terms acceptable to us. We are unable

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to predict which of the many possible future products and services will meet the evolving industry standards and consumer demands. If we fail to make the capital improvements necessary to continue the modernization of our manufacturing operations and reduction of our costs, our competitive position may suffer, and our net sales may decline.

***Unforeseen or recurring operational problems at any of our facilities may cause significant lost production, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.***

Our manufacturing process could be affected by operational problems that could impair our production capability. Each of our facilities contains complex and sophisticated machines that are used in our manufacturing process. Disruptions at any of our facilities could be caused by maintenance outages; prolonged power failures or reductions; a breakdown, failure or substandard performance of any of our machines; the effect of noncompliance with material environmental requirements or permits; disruptions in the transportation infrastructure, including railroad tracks, bridges, tunnels or roads; fires, floods, earthquakes or other catastrophic disasters; labor difficulties; or other operational problems. Any prolonged disruption in operations at any of our facilities could cause significant lost production, which would have a material adverse effect on our business, financial condition, results of operations and cash flows.

***We have made and may continue to make investments in entities that we do not control.***

We have established joint ventures and made minority interest investments designed to increase our vertical integration and increase efficiencies in our procurement, manufacturing processes, marketing and distribution in the United States and other markets. Our principal joint ventures and minority investments include U.N.F. Industries, Ltd., Unifi-SANS Technical Fibers, LLC, Parkdale America, LLC, and Yihua Unifi Fibre Industry Company Limited. See Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Joint Ventures and Other Equity Investments in our annual report on Form 10-K for the fiscal year ended June 25, 2006 for more information. We do not control these entities. Our inability to control entities in which we invest may affect our ability to receive distributions from those entities or to fully implement our business plan. The incurrence of debt or entry into other agreements by an entity not under our control may result in restrictions or prohibitions on that entity s ability to pay dividends or make other distributions to us. Even where these entities are not restricted by contract or by law from making distributions to us, we may not be able to influence the occurrence or timing of such distributions. In addition, if any of the other investors in these entities fails to observe its commitments, that entity may not be able to operate according to its business plan or we may be required to increase our level of commitment. If any of these events were to occur, our business, results of operations, financial condition or cash flows could be adversely affected. Because we do not own a majority or maintain voting control of these entities, we do not have the ability to control their policies, management or affairs. The interests of persons who control these entities or partners may differ from ours, and they may cause such entities to take actions which are not in our best interest. If we are unable to maintain our relationships with our partners in these entities, we could lose our ability to operate in these areas which could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***Our acquisition strategy may not be successful, which could adversely affect our business.***

We have expanded our business partly through acquisitions and anticipate that we will continue to make selective acquisitions. Our acquisition strategy is dependent upon the availability of suitable acquisition candidates, obtaining financing on acceptable terms, and our ability to comply with the restrictions contained in the indenture governing our outstanding notes or under our revolving credit facility. Acquisitions may divert a significant amount of management s time away from the operation of our business. Future acquisitions may also have an adverse effect on our operating results, particularly in the fiscal quarters immediately following their completion while we integrate the operations of the acquired business. Growth by acquisition involves risks that could have a material adverse effect on our business and financial results, including difficulties in integrating the operations and personnel of acquired companies and the potential loss of key employees and customers of

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acquired companies. Once integrated, acquired operations may not achieve the levels of revenues, profitability or productivity comparable with those achieved by our existing operations, or otherwise perform as expected. While we have experience in identifying and integrating acquisitions, we may not be able to identify suitable acquisition candidates, obtain the capital necessary to pursue our acquisition strategy or complete acquisitions on satisfactory terms or at all. Even if we successfully complete an acquisition, we may not be able to integrate it into our business satisfactorily or at all.

***We may not be able to realize in full all of the benefits that we anticipate from the Dillon acquisition.***

The value of our common stock could be affected by our inability to achieve the benefits expected from the Dillon acquisition. Achieving these benefits will depend in part upon meeting the challenges inherent in the successful combination of two businesses, including the possible inability to integrate the operations of Dillon into our operations. We may not be able to meet these challenges, which could have a material adverse effect on our operations following the Dillon acquisition.

***Increases of illegal transshipment of textile and apparel goods into the United States could have a material adverse effect on our business.***

There has been a significant increase recently in illegal transshipments of apparel products into the United States. Illegal transshipment involves circumventing quotas by falsely claiming that textiles and apparel are a product of a particular country of origin or include yarn of a particular country of origin to avoid paying higher duties or to receive benefits from regional free-trade agreements, such as the North American Free Trade Agreement or the U.S.-Dominican Republic-Central America Free Trade Agreement. If illegal transshipment is not monitored and enforcement is not effective, these shipments could have a material adverse effect on our business.

***We are subject to many environmental and safety regulations that may result in significant unanticipated costs or liabilities or cause interruptions in our operations.***

We are subject to extensive federal, state, local and foreign laws, regulations, rules and ordinances relating to pollution, the protection of the environment and the use or cleanup of hazardous substances and wastes. We may incur substantial costs, including fines, damages and criminal or civil sanctions, or experience interruptions in our operations for actual or alleged violations of or compliance requirements arising under environmental laws, any of which could have a material adverse effect on our business, financial condition, results of operations or cash flows. Our operations could result in violations of environmental laws, including spills or other releases of hazardous substances to the environment. In the event of a catastrophic incident, we could incur material costs.

In addition, we could incur significant expenditures in order to comply with existing or future environmental or safety laws. For example, the land associated with our Kinston facility is leased under a 99 year ground lease with E.I. DuPont De Nemours and Company. Since 1993, DuPont has been investigating and cleaning up the Kinston site under the supervision of the U.S. Environmental Protection Agency and the North Carolina Department of Environment and Natural Resources under the Resource Conservation and Recovery Act Corrective Action Program. The Corrective Action Program requires DuPont to identify all potential areas of environmental concern, known as solid waste management units or areas of concern, assess the extent of contamination at the identified areas and clean them up to applicable regulatory standards. Under the terms of the ground lease, upon completion by DuPont of required remedial action, ownership of the Kinston site will pass to us. Thereafter, we will have responsibility for future remediation requirements, if any, at the solid waste management units and areas of concern previously addressed by DuPont and at any other areas at the plant. At this time we have no basis to determine if and when we will have any responsibility or obligation with respect to contaminated solid waste management units and areas of concern or the extent of any potential liability for the same. Accordingly, the possibility that we could face material clean-up costs in the future relating to the Kinston facility cannot be eliminated. Capital expenditures and, to a lesser extent, costs and operating expenses relating to environmental or safety matters will be subject to evolving regulatory requirements and will depend on the

timing of the promulgation and enforcement of specific standards which impose requirements on our operations. Therefore, capital expenditures beyond those currently anticipated may be required under existing or future environmental or safety laws. See Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Liquidity Assessment Other Factors Affecting Liquidity Environmental Liabilities in our annual report on Form 10-K for the fiscal year ended June 25, 2006 for more information.

Furthermore, we may be liable for the costs of investigating and cleaning up environmental contamination on or from our properties or at off-site locations where we disposed of or arranged for the disposal or treatment of hazardous materials or from disposal activities that pre-dated the purchase of our businesses. If significant previously unknown contamination is discovered, existing laws or their enforcement change or our indemnities do not cover the costs of investigation and remediation, then such expenditures could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***Health and safety regulation costs could increase.***

Our operations are also subject to regulation of health and safety matters by the United States Occupational Safety and Health Administration and comparable statutes in foreign jurisdictions where we operate. We believe that we employ appropriate precautions to protect our employees and others from workplace injuries and harmful exposure to materials handled and managed at our facilities. However, claims that may be asserted against us for work-related illnesses or injury, and changes in occupational health and safety laws and regulations in the United States or in foreign jurisdictions in which we operate could increase our operating costs. We are unable to predict the ultimate cost of compliance with these health and safety laws and regulations. Accordingly, we may become involved in future litigation or other proceedings or be found to be responsible or liable in any litigation or proceedings, and such costs may be material to us.

***Our business may be adversely affected by adverse employee relations.***

As of December 24, 2006, we employed approximately 3,030 employees, approximately 2,600 of which are domestic employees and approximately 430 of which are foreign employees. While employees of our foreign operations are generally unionized, none of our domestic employees are currently covered by collective bargaining agreements. The failure to renew our collective bargaining agreements with employees of our foreign operations and other labor relations issues, including union organizing activities, could result in an increase in costs or lead to a strike, work stoppage or slow down. Such labor issues and unrest by our employees could have a material adverse effect on our business.

***We depend on the continued services of key managers and employees.***

Our ability to maintain our competitive position is dependent to a large degree on the services of our senior management team, including our Chief Executive Officer, Mr. Parke, and our Chief Operating Officer and Chief Financial Officer, Mr. Lowe. We currently do not have any employment agreements with our senior management team other than Mr. Parke and Mr. Lowe and cannot assure you that any of these individuals will remain with us. We currently do not have a life insurance policy on any of the members of the senior management team. The death or loss of the services of any of our senior managers or the inability to attract and retain additional senior management personnel could have a material adverse effect on our business.

***Our future financial results could be adversely impacted by asset impairments or other charges.***

Under Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we are required to assess the impairment of our long-lived assets, such as plant and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable as measured by the sum of the expected future undiscounted cash flows. When we determine that the carrying value of certain long-lived assets may not be recoverable based upon the existence of one or more impairment

indicators, we then measure any impairment based on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in our current business model. In accordance with SFAS No. 144, any such impairment charges will be recorded as operating losses. See Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Impairment of Long-Lived Assets in our annual report on Form 10-K for the fiscal year ended June 25, 2006 for more information.

In addition, we evaluate the net values assigned to various equity investments we hold, such as our investment in U.N.F. Industries, Ltd., Unifi-SANS Technical Fibers, LLC, Parkdale America, LLC, and Yihua Unifi Fibre Industry Company Limited in accordance with the provisions of Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. APB No. 18 requires that a loss in value of an investment, which is other than a temporary decline, should be recognized as an impairment loss. Any such impairment losses will be recorded as operating losses. See Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Joint Ventures and Other Equity Investments in our annual report on Form 10-K for the fiscal year ended June 25, 2006 for more information.

Any operating losses resulting from impairment charges under SFAS No. 144 or APB No. 18 could have an adverse effect on our net income and therefore the market price of our securities, including our common stock.

***Our business could be adversely affected if we fail to protect our intellectual property rights.***

Our success depends in part on our ability to protect our intellectual property rights. We rely on a combination of patent, trademark, and trade secret laws, licenses, confidentiality and other agreements to protect our intellectual property rights. However, this protection may not be fully adequate: our intellectual property rights may be challenged or invalidated, an infringement suit by us against a third party may not be successful and/or third parties could design around our technology or adopt trademarks similar to our own. In addition, the laws of some foreign countries in which our products are manufactured and sold do not protect intellectual property rights to the same extent as the laws of the United States. Although we routinely enter into confidentiality agreements with our employees, independent contractors and current and potential strategic and joint venture partners, among others, such agreements may be breached, and we could be harmed by unauthorized use or disclosure of our confidential information. Further, we license trademarks from third parties, and these agreements may terminate or become subject to litigation. Our failure to protect our intellectual property could materially and adversely affect our competitive position, reduce revenue or otherwise harm our business.

Further, we may be accused of infringing or violating the intellectual property rights of third parties. Any such claims, whether or not meritorious, could result in costly litigation and divert the efforts of our personnel. Should we be found liable for infringement, we may be required to enter into licensing arrangements (if available on acceptable terms or at all) or pay damages and cease selling certain products or using certain product names or technology. Our failure to prevail in any intellectual property litigation could materially adversely affect our competitive position, reduce revenue or otherwise harm our business.

**Risks Relating to Our Common Stock**

***We do not expect to pay dividends on our common stock in the foreseeable future, and, because we are a parent company, with no independent operations of our own and are subject to restrictions on our ability to pay dividends under our debt agreements, we may be unable to pay dividends on our common stock.***

We do not expect to pay cash dividends on our common stock in the foreseeable future. Our board of directors will determine whether to pay dividends in the future based on conditions then existing, including our earnings, financial condition and capital requirements, as well as economic and other conditions our board of directors may deem relevant. Furthermore, because we are a parent company with no independent operations of

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our own, we are dependent upon the operations of our subsidiaries for cash, and the indenture governing our outstanding senior secured notes and our revolving credit facility impose restrictions on our subsidiaries ability to distribute cash to us. See The indenture governing our senior secured notes and our revolving credit facility impose significant operating and financial restrictions, which may prevent us from pursuing certain business opportunities and taking certain actions. In addition, our ability to generate cash is subject to a number of risks beyond our control, and we will be required to devote a large portion of our cash flows to servicing our debt, making capital expenditures and other liquidity needs, so the amount of funds available for dividends on our common stock will likely be limited. See We will require a significant amount of cash to service our indebtedness, and our ability to generate cash depends on many factors beyond our control. As a result, after servicing our indebtedness, making capital expenditures and satisfying our other liquidity needs, our ability to pay dividends on our common stock will be limited. Accordingly, we may not be able to pay dividends even if our board of directors would otherwise deem it appropriate. For these reasons, you will not be able to rely on dividends to receive a return on your investment.

***Provisions of New York law and in our debt agreements may discourage a takeover attempt even if doing so may be beneficial to our shareholders.***

Certain anti-takeover provisions of New York law could delay or hinder a change of control of our company. While such provisions generally facilitate our board of directors ability to maximize shareholder value, they may discourage takeovers that could be in your best interests. In addition, the agreements governing our indebtedness contain provisions that may require us to repay our indebtedness upon the occurrence of a change of control. Such provisions also may tend to discourage takeovers that could be in your best interests. Any of the provisions described above could adversely affect the market value of our common stock.

***Our stock price may be volatile and you may lose all or part of your investment.***

The market price of our common stock could fluctuate significantly as a result of a variety of factors, many of which are beyond our control. These factors include:

- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- our operating performance and the performance of our competitors and other similar companies;
- the public s reaction to our press releases, our other public announcements and our filings with the SEC;
- changes in general economic conditions;
- changes in earnings estimates or recommendations by research analysts who track our common stock or the stocks of other companies in our industry;
- the number of shares publicly traded after this offering;
- actions of our current shareholders, including sales of common stock by our directors and executive officers; and
- other developments affecting us, our industry and our competitors.

In addition, in recent years the stock market has experienced significant price and volume fluctuations. These fluctuations are often unrelated to the operating performance of particular companies. These broad market fluctuations may cause declines in the market price of our common stock. The price of our common stock could fluctuate based upon factors that have little or nothing to do with us or our performance, and these

fluctuations could materially reduce our stock price.

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## FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are those that do not relate solely to historical fact. They include, but are not limited to, any statement that may predict, forecast, indicate or imply future results, performance, achievements or events. They may contain words such as believe, anticipate, expect, estimate, intend, project, plan, will, or words or phrases of similar meaning. They may relate to, among other things, the risks des under the caption Risk Factors and:

- the competitive nature of the textile industry and the impact of worldwide competition;
- changes in the trade regulatory environment and governmental policies and legislation;
- the availability, sourcing and pricing of raw materials;
- general domestic and international economic and industry conditions in markets where we compete, such as recession and other economic and political factors over which we have no control;
- our ability to reduce production costs;

| | | |
|---|---|---|
| chont size="2" face="Times New Roman" style="font-size:1.0pt;">41,200 | | 41,200 |
| D. Michael Hawbaker | 39,200 | 39,200 |
| Leroy H. Keiler, III | 41,900 | 41,900 |
| R. Edward Nestlerode, Jr. | 37,700 | 37,700 |
| James E. Plummer | 45,400 | 45,400 |
| William H. Rockey | 39,200 | 39,200 |
| Hubert A. Valencik | 41,200 | 41,200 |
| Ronald A. Walko | 35,400 | 35,400 |

(1) Represents portion, if any, of interest credited to the director s deferred fee account which exceeds 120% of the applicable federal rate under the Internal Revenue Code. The director fee agreements are described below.

The Corporation paid a $10,000 retainer fee to each director of the Corporation during 2011. All directors of the Bank received $1,000 for each meeting of the Board of Directors of the Bank, $500 for each Audit or Asset Liability Committee meeting, and $400 for all other committee meetings of the Board of Directors of the Bank that the director attended during 2011. In addition, directors receive compensation for accompanying an officer on property appraisals at a rate of $20 for the first hour and $10 for each subsequent hour. The director serving as the Secretary of the Board of Directors receives $200 per meeting. In the aggregate, the existing Board of Directors of the Corporation earned $391,800 for all Board and committee meetings of the Corporation and the Bank attended. This total also includes the total received for appraisals and the secretarial function. A portion of fees earned are used to fund a deferred compensation plan for the directors who participated in this plan.

The Bank and Directors Casale, Furey, Rockey, and Walko have entered into director fee agreements pursuant to which each participating director may defer payment of all or a portion of his director s fees earned for service on the Boards of Directors of the Corporation and the Bank. The Bank has established a deferral account for each participating director on its books. Benefits are funded by each director s fees and the Bank s general assets and are payable upon retirement, early termination, disability, death, or the occurrence of a change in control of the Corporation or the Bank. Interest is credited to each deferral account at an annual rate equal to 50% of the Corporation s return on equity for the immediately prior year, compounded monthly. Following termination of service, interest is credited to a deferral account at a rate based on the yield of the 10-year treasury note. A participating director may receive a benefit if the Board of Directors has determined

that, following a request by a participating director, such director has suffered a severe unforeseeable financial hardship and becomes payable at the Board of Directors discretion. Generally, the payments are payable, at the participating director s prior election, in a lump sum or in 60 equal monthly installments. Following the occurrence of a triggering event, payments will commence within 30 days after, at the participating director s prior election, his retirement or termination of service, or the occurrence of a change in control of the Corporation or the Bank. If payments were not triggered until the participating director s death, the benefits will be paid within 90 days following receipt of the director s death certificate.

Mr. Grafmyre did not receive any director fees during 2011. Commencing in 2011, employee directors elected to the Board for the first time during 2010 and in any year thereafter (including Mr. Grafmyre) will not receive any separate compensation for serving as a director of the Corporation or the Bank.

## COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Directors Casale, Davis, Furey, Hawbaker, Keiler, Nestlerode, and Valencik have lending relationships with the Bank, our wholly owned banking subsidiary, which were made, and presently are, in compliance with Regulation O under the federal banking laws. For more information relating to loans to our directors, see Certain Transactions. With these exceptions, no member of the Compensation and Benefits Committee (i) was, during the 2011 fiscal year, or had previously been, an officer or employee of the Corporation or its subsidiaries or (ii) had any direct or indirect material interest in a transaction of the Corporation or a business relationship with the Corporation, in each case that would require disclosure under applicable rules of the SEC. No other interlocking relationship existed between any member of the Compensation and Benefits Committee or an executive officer of the Corporation, on the one hand, and any member of the Compensation Committee (or committee performing equivalent functions, or the full Board of Directors) or an executive officer of any other entity, on the other hand, requiring disclosure pursuant to the applicable rules of the SEC.

## PROPOSAL NO. 1
## ELECTION OF DIRECTORS

The bylaws provide that the Board of Directors shall consist of not less than five (5) nor more than twenty-five (25) directors who are shareholders, the exact number to be fixed and determined from time to time by resolution of the full Board of Directors or by resolution of the shareholders at any annual or special meeting. The Articles of Incorporation and Bylaws further provide that the directors shall be divided into three (3) classes, as nearly equal in number as possible, known as Class 1, Class 2, and Class 3. The directors of each class serve for a term of three (3) years and until their successors are elected and qualified. Under Pennsylvania law, directors of the Corporation can be removed from office by a vote of shareholders only for cause. Following the death of Director James E. Plummer in 2011, Director Ronald A.Walko moved from Class 1 to Class 2 to maintain each class as nearly equal in number as possible as required by Pennsylvania law and the Corporation s articles of incorporation and bylaws, and the Board of Directors set the number of directors at ten (10). The directors of the Corporation serve as follows:

| Nominees for election of Class 2 Directors whose term expires in 2015: | Class 3 Directors to serve until 2014: | Class 1 Directors to serve until 2013: |
|---|---|---|
| Leroy H. Keiler, III (age 48) | H. Thomas Davis, Jr. (age 63) | Michael J. Casale, Jr. (age 60) |
| Hubert A. Valencik (age 70) | James M. Furey, II (age 64) | R. Edward Nestlerode, Jr. (age 59) |
| Ronald A. Walko (age 65) | Richard A. Grafmyre (age 58) | William H. Rockey (age 65) |
| | D. Michael Hawbaker (age 44) | |

The Board of Directors has affirmatively determined that all of the Corporation s directors are independent within the meaning of the NASDAQ listing standards, except for Ronald A. Walko, Chairman of the Board and former President and Chief Executive Officer of the Corporation and the Bank, William H. Rockey, former Senior Vice President of the Corporation and the Bank, and Richard A. Grafmyre, President and Chief Executive Officer of the Corporation and the Bank. The Board categorically determined that a lending relationship resulting from a loan made by the Bank to a director would not affect the determination of independence if the loan complies with Regulation O under the federal banking laws. The Board also categorically determined that maintaining with the Bank a deposit, savings, or similar account by a director or any of the director s affiliates would not affect the determination of independence if the account is maintained on the same terms and conditions as those available to similarly situated customers.

The proxies solicited hereunder will be voted FOR (unless otherwise directed) the three (3) director nominees of the Board of Directors listed previously for election as Class 2 directors. Each nominee has agreed to serve if elected and qualified. The Corporation does not contemplate that any nominee will be unable to serve as a director for any reason. However, in the event one or more of the nominees should be unable to stand for election, proxies will be voted for the remaining nominees and such other persons selected by the Board of Directors, in accordance with the best judgment of the proxy holders.

**INFORMATION AS TO NOMINEES AND DIRECTORS**

Set forth below is the principal occupation and certain other information regarding the nominees and other directors whose terms of office will continue after the annual meeting. In addition, below we provide the particular experience, qualification, attributes, or skills that led the Board of Directors to conclude that each director and nominee should serve as a director. Share ownership information for each director and nominee is included under Beneficial Ownership and Other Information Regarding Directors and Management.

**NOMINEES FOR DIRECTOR**

**Leroy H. Keiler, III** operates Leroy H. Keiler, Attorney at Law. Mr. Keiler has served as a director of the Corporation since 2006. Because banking is a highly regulated industry and success in the industry is dependent on adequately managing certain lending risks, Mr. Keiler s experience as an attorney is helpful to the Board in reviewing the Bank s legal matters and documentation related to residential lending matters. Additionally, Mr. Keiler s relatively younger age adds to the diversity of the Board and helps to ensure that the Board will develop Board members with a depth of knowledge of the Corporation and the Bank, in order to avoid knowledge and experience voids as older Board members retire.

**Hubert A. Valencik** is a retired former Senior Vice President and Chief Operations Officer of the Bank and Senior Vice President of the Corporation. Mr. Valencik has served as a director of the Corporation since 2005. As the former Chief Operations Officer of the Bank, Mr. Valencik continues to provide the Board valuable insight and information regarding the operations of the Bank, which assists the Board in providing adequate levels of management oversight.

**Ronald A. Walko** is the Chairman of the Board of the Corporation and the Bank. He joined the Bank in 1986 as Vice President and Senior Loan Officer. He was elected Executive Vice President and Chief Executive Officer of Penns Woods Bancorp, Inc. and the Bank in May 1999, and served as the President and Chief Executive Officer of Penns Woods Bancorp, Inc. and the Bank from August 2000 until October 2010. With 25 plus years of service with the Bank, Mr. Walko possesses a deep understanding of the Bank s.

**DIRECTORS CONTINUING IN OFFICE**

**Michael J. Casale, Jr.** is the principal of Michael J. Casale, Jr., Esq., LLC. Mr. Casale has served as a director of the Corporation since 1999. Because banking is a highly regulated industry and success in the industry is dependent on adequately managing certain lending risks, Mr. Casale s experience as an attorney is helpful to the Board in reviewing the Bank s legal matters and documentation related to commercial lending matters.

**H. Thomas Davis, Jr.** is Chairman and Chief Executive Officer of Davis Insurance Agency, Inc. a provider of property and casualty insurance. Mr. Davis has served as a director of the Corporation since 1999. Mr. Davis extensive knowledge of the insurance industry remains important to the Board for its oversight of the Bank s wholly owned subsidiary, The M Group, Inc., d/b/a The Comprehensive Financial Group, which sells insurance products.

**James M. Furey, II** is President and owner of Eastern Wood Products. Mr. Furey has served as a director of the Corporation since 1990. Through Mr. Furey s professional experience in the lumber industry, which is significant in the Williamsport region, he has developed strong ties to the community there, which remains the Bank s primary market. From these community relationships, Mr. Furey provides the Board with insight as to the growth opportunities and real estate industry within the Williamsport region.

**Richard A. Grafmyre** has served as President and Chief Executive Officer of the Corporation and the Bank since joining the Corporation in October 2010. Prior to joining the Corporation, Mr. Grafmyre served as President, Chief Executive Officer, and Chairman of FNB Bank since 1997. For the efficient operation of the Board, the Board believes that the President and Chief Executive Officer should have a position on the Board to act as a liaison between the Board and management and to assist with the Board s oversight responsibilities by ensuring the Board receives information from management in a timely and accurate manner to permit the Board to carry out its responsibilities effectively. Mr. Grafmyre s extensive professional banking experience within a larger holding company structure enables him to provide the Board with insight as to how the Bank s operations, policies, and implementation of strategic plans compare to those of its peers.

**D. Michael Hawbaker** is Executive Vice President of Glenn O. Hawbaker, Inc., a provider of heavy construction services and products throughout the company s market area in Centre County, Pennsylvania. Mr. Hawbaker has served as a director of the Corporation since 2007. Mr. Hawbaker, as our youngest Board member, adds to the diversity of the Board and helps to ensure that the Board will develop Board members with a depth of knowledge of the Corporation and the Bank, in order to avoid knowledge and experience voids as older Board members retire. Additionally, Mr. Hawbaker understands the community and political landscape of the Centre County area where the Board intends to continue to grow the Bank s business. Mr. Hawbaker possesses a level of financial acumen important to his service as a member of the Audit Committee.

**R. Edward Nestlerode, Jr.** is a Vice President and Chief Executive Officer of Nestlerode Contracting Co., Inc., which specializes in bridge building. Mr. Nestlerode has served as a director of the Corporation since 1995. Mr. Nestlerode maintains strong community ties in the Clinton County area, which is a region that the Bank intends to grow its business. Through his business, Mr. Nestlerode has developed knowledge of the construction industry, which provides the Board with insight regarding the development of potential customer relationships and opportunities for the Bank. In addition, Mr. Nestlerode s previous experience as a Chief Financial Officer is valuable as a member of the Audit Committee.

**William H. Rockey** is a retired former Senior Vice President of the Corporation and the Bank. He was the president of the former First National Bank of Spring Mills. Mr. Rockey has served as a director of the Corporation since 1999. Mr. Rockey s ties to Centre County, Pennsylvania will assist the Bank in growing its business in the Centre County region. In addition, Mr. Rockey s former position with the Corporation, along with his long-time professional banking experience in Centre County, Pennsylvania, combined with his knowledge and familiarity of the Bank s culture and operating procedures, provide the Board with significant business development resources and experience.

## PRINCIPAL OFFICERS OF THE CORPORATION

The following table lists the executive officers of the Corporation as of March 1, 2012:

| Name | Age | Position and/or Offices With the Corporation | Bank Employee Since | Number of Shares of the Corporation | Year First Elected an Officer |
|---|---|---|---|---|---|
| Richard A. Grafmyre | 58 | President & Chief Executive Officer | 2010 | 1,078 | 2010 |
| Brian L. Knepp | 37 | Chief Financial Officer | 2005 | 619 | 2005 |
| Ann M. Riles | 57 | Senior Vice President and Chief Credit Officer | 1983 | 5,045 | 2007 |

Biographical information for Mr. Grafmyre is set forth above under the caption Information as to Nominees and Directors.

Mr. Knepp joined the Bank in 2005 as Vice President Finance and became the Chief Financial Officer in April 2008.

Ms. Riles joined the Bank in 1983 as a loan officer, and was appointed Senior Vice President and Chief Credit Officer in 2007.

## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

### PRINCIPAL OWNERS

As of March 1, 2012, there were no persons who owned of record or who are known by the Board of Directors to be beneficial owners of more than 5% of the Corporation s common stock.

**BENEFICIAL OWNERSHIP AND OTHER INFORMATION REGARDING DIRECTORS AND MANAGEMENT**

The following table sets forth, as of March 1, 2012, information regarding the number of shares and percentage of the outstanding shares of common stock beneficially owned by each director, executive officer, and as a group. Unless otherwise indicated in a footnote, shares of our common stock have not been pledged as security.

| Name | Principal Occupation for Past Five Years | Year First Became a Director | Amount & Nature of Beneficial Ownership | % of Total Shares Outstanding |
|---|---|---|---|---|
| Michael J. Casale, Jr. | Principal, Michael J. Casale, Jr., Esq., LLC | 1999 | 21,584(1) | 0.56% |
| H. Thomas Davis, Jr. | Chairman & Chief Executive Officer of Davis Insurance Agency, Inc. | 1999 | 18,445(2) | 0.48% |
| James M. Furey, II | President & Owner of Eastern Wood Products | 1990 | 14,607(3) | 0.38% |
| Richard A. Grafmyre | President & Chief Executive Officer of the Corporation and Bank | 2010 | 1,078(4) | 0.03% |
| D. Michael Hawbaker | Executive Vice President of Glenn O. Hawbaker, Inc. | 2007 | 800(5) | 0.02% |
| Leroy H. Keiler, III | Leroy H. Keiler, III, Attorney at Law | 2006 | 549(6) | 0.01% |
| Brian L. Knepp | Chief Financial Officer of the Corporation and Bank | N/A | 619(7) | 0.02% |
| R. Edward Nestlerode, Jr. | Vice President and Chief Executive Officer of Nestlerode Contracting Co., Inc. | 1995 | 16,200(8) | 0.42% |
| Ann M. Riles | Senior Vice President & Chief Credit Officer of the Corporation and Bank | N/A | 5,045(9) | 0.13% |
| William H. Rockey | Retired; Former Senior Vice President of the Corporation and Bank; Former President of First National Bank of Spring Mills | 1999 | 32,912(10) | 0.86% |
| Hubert A. Valencik | Retired; Former Senior Vice President & Chief Operations Officer of the Bank; Former Senior Vice President of the Corporation | 2005 | 15,078(11) | 0.39% |
| Ronald A. Walko | Chairman of the Board; Former President & Chief Executive Officer of the Corporation and Bank | 2000 | 22,516(12) | 0.59% |
| All Executive Officers and Directors as a Group | | | 149,433 | 3.89% |

(1) Includes 15,918 shares held jointly with his spouse, 660 shares held by his spouse, and 5,006 shares held by his children.

(2) Shares held individually.

(3) Includes 6,547 shares held jointly with his spouse, 6,430 held individually, and 1,630 shares held by his spouse.

(4) Shares held individually.

(5) Includes 600 shares held jointly with his spouse and 200 shares held individually.

(6) Shares held jointly with his spouse.

(7) Shares held individually.

(8) Includes 7,631 shares held jointly with his spouse and his father, 6,858 shares held individually, 501 shares held by his children, and 1,210 shares held by Nestlerode Contracting Co., Inc.

(9) Includes 3,542 shares held jointly with her spouse and 1,503 shares held individually.

(10) Includes 31,670 shares held jointly with his spouse, and 1,242 shares held individually.

(11) Includes 3,310 shares held jointly with his spouse, and 11,768 shares held individually.

(12) Includes 19,896 shares held jointly with his spouse and children, 2,083 shares held individually, 435 shares held by his spouse, and 102 shares held jointly by his spouse and children.

## SECTION 16 (a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act ) requires our officers and directors, and any persons owning ten percent or more of our common stock, to file in their personal capacities initial statements of beneficial ownership on Form 3, statements of changes in beneficial ownership on Form 4, and annual statements of beneficial ownership on Form 5 with the Securities and Exchange Commission (the SEC ). Persons filing such beneficial ownership statements are required by SEC regulation to furnish us with copies of all such statements filed with the SEC. The rules of the SEC regarding the filing of such statements require that late filings be disclosed in the Corporation s proxy statement. Based solely on the reports received by us or filed with the SEC and on written representations from reporting persons, we believe all such persons complied with all applicable filing requirements during 2011, with the exception of Mr. Plummer, for whom one late Form 4 was filed reporting a single transaction.

## COMPENSATION DISCUSSION AND ANALYSIS

The Compensation Discussion and Analysis addresses the following issues: members of the Compensation and Benefits Committee (the Committee ) and their role, compensation-setting process, philosophy regarding executive compensation, and components of executive compensation.

**Committee Members and Independence**

The Committee is comprised of four (4) independent directors under the requirements set forth in the NASDAQ listing standards. The members of the Committee are: Michael J. Casale, Jr., H. Thomas Davis, Jr., D. Michael Hawbaker, and R. Edward Nestlerode, Jr.

**Role of Committee**

The Committee s focus is to establish a compensation policy and philosophy that will enable the Corporation to attract, retain, motivate, and reward executive officers that are critical to the success of the Corporation. In doing so, the Committee:

- reviews and adjusts the principles guiding the compensation policy to maintain alignment with short and long-term strategic goals and to build shareholder value;
- establishes performance objectives including, but not limited to, earnings, return on assets, return on equity, total assets, and quality of the loan portfolio;
- evaluates the performance of the executive officers in comparison to the performance goals;
- determines the compensation of executive officers and the components of the compensation;
- administers the retirement plans of the Corporation, including the defined benefit, defined contribution, and 401(k) plans;
- administers the 2006 Employee Stock Purchase Plan;
- recommends changes to compensation plans, cash or equity, to the full Board of Directors;
- reviews and recommends changes to succession plans; and
- reviews and recommends changes to director compensation.

**Committee Meetings**

The Committee meets as often as necessary. During 2011, the Committee held one meeting at which it determined and approved wage and benefit changes for the 2012 fiscal year. The Committee does not maintain a written charter. The Committee works with the President and Chief Executive Officer to determine the meeting agenda and material to be reviewed. The materials and inputs utilized may include, but are not limited to, the following:

- financial reports outlining budget to actual performance;

- reports of corporate achievement/recognition by outside parties;
- forecasted financial results as compared to the current budget and actual results;
- peer financial analysis and comparison;
- completion and progress of meeting strategic goals;
- peer equity and cash compensation data;
- national and regional compensation surveys; and
- financial impact of current and proposed compensation programs.

**Committee Process**

The Committee sets the compensation of the executive officers and other employees during the fourth quarter of each fiscal year for the next year. Although the decisions are made in the fourth quarter, the Committee continuously monitors the performance of the Corporation and executives throughout the year as part of the routine full Board of Directors meetings.

The Committee utilizes the input and assistance of management when making compensation decisions. Management input includes:

- employee performance evaluations and compensation recommendations;
- reporting actual and forecasting future results;
- establishing performance objectives;
- review and recommendations of non-cash employee compensation programs; and
- assistance with Committee meeting agendas.

The President and Chief Executive Officer has direct involvement with the Committee during the meetings in order to provide status updates on the attainment of strategic goals, discuss performance evaluations, and make recommendations on executive officer compensation packages, for the named executive officers other than himself.

Annually, the Committee meets to evaluate the performance of the executive officers, set the compensation for the following fiscal year, and to determine their cash bonus to be paid for the current year.

**Compensation Elements**

**Base Salary**

The Committee believes that the base salary of the named executive officers is the cornerstone of the compensation package and is the primary source of compensation to the executive. The base salary provides a consistent level of pay to the executive, which the Committee feels decreases the amount of executive turnover, promotes the long-term goals of the Corporation, and is a tax deductible expense. The factors used in determining the level of base salary include the executive s qualifications and experience, tenure with the Corporation, responsibilities, attainment of goals and objectives, past performance, and peer practices. A review of past performance and the attainment of goals and objectives are reviewed annually as part of the formal annual performance review. During the review, which occurs during the fourth quarter, objectives and goals for the next year and upcoming milestones related to the corporate strategic plan are discussed. Peers for the Corporation are bank holding companies within the Philadelphia Federal Reserve District with assets between $500 million and $1 billion and include the following:

| | | |
|---|---|---|
| AmeriServ Financial, Inc. | CCFNB Bancorp, Inc. | Citizens Financial Services, Inc. |
| Dimeco, Inc. | DNB Financial Corporation | ENB Financial Corp. |
| Fidelity D & D Bancorp, Inc. | First Keystone Corporation | Franklin Financial Services Corp. |
| Harleysville Savings Financial Corp. | Honat Bancorp, Inc. | Integrity Bancshares, Inc. |
| Mid Penn Bancorp, Inc. | Penseco Financial Services Corp. | QNB Corporation |

Data for these peers is gathered from various sources including, but not limited to, SEC filings, Federal Reserve filings, and other information publicly released by the peer companies. The Committee utilizes such comparative information as one component solely for determining base salary for such executives. Other components considered by the Committee include the factors described above. The Committee does not assign relative weights to any one component but considers the entire mix of information. The Committee does not consider such comparative information in connection with other elements of the overall compensation of such executives.

**Annual Bonus Program**

The Committee administers a Performance-Based Cash Incentive Plan originally adopted in March 2010. The plan provides at-risk compensation awards to eligible employees, which include full-time employees of the Bank (except employees who are eligible for employee commission incentive programs) and part-time employees who are eligible to participate in the Bank s Pension Plan and/or 401(k) Plan. In addition, the employee must receive an overall rating of Good or higher on his or her most recent individual performance appraisal prior to the end of the plan year. The plan is designed to support organizational objectives and financial goals set forth in the Bank s strategic business plan and financial plan. The plan further aligns the interests of the Corporation s shareholders with those of the Bank s employees and assists the Bank in attracting, retaining, and motivating high-quality personnel, who contribute to the success and profitability of the Bank.

The Committee by resolution establishes six target results criteria on an annual basis. Target results are the annual goals of the Bank, which are consistent with the Bank s strategic business plan and financial plan, which must be met in order to receive a cash award under the plan. The target results integrate industry peer group standards with the goals set forth in the Bank s strategic business plan and financial plan. Targets are weighted to reflect the relative importance of each goal to the Bank s goals under its strategic business plan and financial plan. Target measures that may be used by the Committee include, but are not limited to, return on equity, gross loan growth, growth in deposits (excluding brokered deposits), growth in core deposits, net interest margin, and net overhead as a percent of average assets. Target results are set at levels intended to be challenging, but more likely than not to be achieved, or come substantially close to being achieved.

The Committee has the discretion to exclude nonrecurring or extraordinary items of income, gain, expense, or loss, or any other factor it may deem relevant in its determination as to whether the target results have been satisfied. The Committee must conclude that an award, in such a circumstance, would ensure that the best interests of the Bank and the Corporation s shareholders are protected and are not in conflict with the interests of the plan s participants.

Cash awards are based upon a percentage of eligible compensation, which will be the employee s Form W-2 gross wages net of any amount included as a payment for any prior year bonus awards. The higher the eligible employee s position is with the Bank, the greater the percentage of the employee s eligible compensation may be received as a cash award. This reflects the Bank s belief that the performance of our named executive officers and other members of upper management has relatively greater impact on the performance of the Bank.

If the plan participants employment is terminated with the Bank, other than retirement (which generally will be attaining the age of 65) or death during the plan year, the participant will not be eligible to receive a bonus award even if the target results are reached. If plan participant is terminated as a result of death or retirement and the participant worked at least six months during the plan year, the

participant, or in the case of death, the participant s beneficiary, will be eligible to receive a pro-rated bonus at the same time and manner as cash bonuses are paid to the other participants in the plan.

The plan is administered by the Committee, but annual awards determined by the Committee under the plan are subject to the approval of the Board of Directors of the Bank. The Committee may only make awards when it deems such awards are in the best interests of the Bank, the Corporation s shareholders, and the plan participants. The Committee or the Board may take action to amend, modify, suspend, reinstate, or terminate the Plan at any time. Such amendments, modifications, suspensions, reinstatements, or terminations may apply retroactively.

For 2011, the Committee established six weighted performance targets to be satisfied as a condition to the payment of any bonuses under the plan for 2011. The performance factors and weightings for each factor for 2011, all of which exclude securities gains or losses where applicable, were as follows: Return on Equity (target: 16.18%; weighting: 30%); Gross Loan Growth (target: $19.894 million; weighting: 20%); Deposit Growth, excluding brokered deposits (target: $46.377 million; weighting: 5%); Core Deposit Growth (target: $15.628 million; weighting: 15%); Net Interest Margin (target: 4.48%; weighting: 15%); and Net Overhead as a Percentage of Average Assets (target: 1.86%; weighting: 15%). The Bank s actual performance measured against the weighted target performance factors resulted in performance of approximately 170% of targeted goals and resulted in potential cash awards for Tier 1 participants (the President and CEO) of up to 36.0% of base salary, and cash awards for Tier 2 participants of up to 26.5% of base salary. Based on these factors, Mr. Grafmyre received a bonus of $88,536 for 2011, Mr. Knepp received a bonus of $28,956 for 2011, and Ms. Riles received a bonus of $35,946 for 2011.

**Equity Awards**

The Committee currently does not use stock options or other equity-based awards as part of the compensation package for its named executive officers. The Committee feels that the cash compensation provided at this time adequately rewards the named executive officers for their contribution to the Corporation. In addition, the Committee believes shareholder value is better enhanced by the use of cash payments to the named executive officers versus the issuance of options or other equity-based awards, which may lead to an increased number of outstanding shares causing diminished share-based returns. The named executive officers, as with all employees, wishing to acquire the Corporation s common stock are eligible to participate in the 2006 Employee Stock Purchase Plan.

**Additional Benefits**

The named executive officers may participate in other employee benefit programs that are generally available to the other employees of the Corporation. Other perquisites received by the named executive officers are either included in the Summary Compensation Table in this proxy statement or do not exceed $10,000 in the aggregate annually.

**Employment Agreements**

We have entered into employment agreements with Messrs. Grafmyre and Knepp and Ms. Riles. A discussion of these agreements follows.

**Richard A. Grafmyre.** On October 29, 2010, Mr. Grafmyre entered into an employment agreement with the Corporation and the Bank. The initial term of the agreement is three years and the agreement annually renews for a term ending one year from each annual anniversary date. Under the terms of the agreement, Mr. Grafmyre will receive an annual base salary of at least $265,000, subject to increases by the Corporation and the Bank. Mr. Grafmyre is also entitled to participate in any pension, retirement, profit sharing, stock option, incentive bonus, employee stock ownership, or other plans, benefits, and privileges available to employees and executive officers of the Corporation and the Bank. In addition, Mr. Grafmyre is entitled to the use of a mid-size automobile for business and ancillary personal use and payment of initiation fees, and membership assessments and dues for him and his spouse at two clubs.

The agreement may be terminated by the Corporation and the Bank for cause (as defined in the agreement), in which case the parties obligations under the agreement will cease. If the agreement is terminated by the Corporation and the Bank without cause and there has not been a change-in-control (as defined in the agreement), then the Corporation and the Bank will continue to pay Mr. Grafmyre s then current annual base salary for the greater of six months or the number of months remaining in the term of his employment agreement and maintain the same level of contributions toward Mr. Grafmyre s continued participation in the Bank s medical/health insurance in effect. In the event that medical/health insurance cannot be provided for Mr. Grafmyre, the Bank will pay him a dollar amount equal to cost of maintaining such insurance. If, following a change-in-control, the agreement is terminated by the Corporation and the Bank without cause or Mr. Grafmyre voluntarily terminates his employment for good reason (as defined in the agreement), the Corporation or the Bank will pay Mr. Grafmyre, in cash, within 30 days of termination, an aggregate amount equal to two times Mr. Grafmyre s then base salary; provided, however, that in the event the lump sum payment described above, when added to all other amounts or benefits provided to Mr. Grafmyre upon termination, would result in the imposition of an excise tax under Section 4999 of the Internal Revenue Code of 1986, as amended (the Code ), the payment will be reduced to the extent necessary to avoid imposition of the tax. If during the term of the agreement, Mr. Grafmyre voluntarily terminates employment, retires, dies, or becomes disabled (as defined in the agreement), the obligations of the parties under the agreement will cease, unless Mr. Grafmyre dies or becomes disabled after providing notice of

termination for good reason following a change in control, in which case, Mr. Grafmyre, or his estate, as the case may be, will be entitled to the amounts described above.

The agreement contains noncompete covenants which generally prohibit Mr. Grafmyre from engaging in banking activities within twenty-five miles of 300 Market Street, Williamsport, Pennsylvania. These covenants generally extend for a period of one year after Mr. Grafmyre s termination of employment unless his employment terminates as a result of a delivery of a notice of nonrenewal by the Corporation and the Bank, in which case these covenants end on the date the agreement terminates.

**Brian L. Knepp.** On June 1, 2010, Mr. Knepp entered into an employment agreement with the Corporation and the Bank. The initial term of the agreement is three years and the agreement annually renews for a term ending one year from each annual anniversary date. Under the terms of the agreement, Mr. Knepp will receive an annual base salary of at least $116,480, subject to increases by the Corporation and the Bank. Mr. Knepp is also entitled to participate in any pension, retirement, profit sharing, stock option, incentive bonus, employee stock ownership, or other plans, benefits, and privileges available to employees and executive officers of the Corporation and the Bank.

The agreement may be terminated by the Corporation and the Bank for cause (as defined in the agreement), in which case the parties obligations under the agreement will cease. If the agreement is terminated by the Corporation and the Bank without cause and there has not been a change-in-control (as defined in the agreement), then the Corporation and the Bank will continue to pay Mr. Knepp s then current annual base salary for the number of months remaining in the term of his employment agreement and provide Mr. Knepp, at no cost to him, with continuation of health and medical benefits for a period of two years following termination of employment. In the event that health and medical benefits cannot be provided, a dollar amount equal to the after-tax cost of obtaining such benefits will be provided to Mr. Knepp. If, following a change-in-control, the agreement is terminated by the Corporation and the Bank without cause or Mr. Knepp voluntarily terminates his employment for good reason (as defined in the agreement), the Corporation or the Bank will pay Mr. Knepp, in cash, within 30 days of termination, an aggregate amount equal to two times Mr. Knepp s then base salary; provided, however, that in the event the lump sum payment described above when added to all other amounts or benefits provided to Mr. Knepp upon termination would result in the imposition of an excise tax under Section 4999 of the Code, the payment will be reduced to the extent necessary to avoid imposition of the tax. If during the term of the agreement, Mr. Knepp voluntarily terminates employment, retires, dies, or becomes disabled (as defined in the agreement), the obligations of the parties under the agreement will cease, unless Mr. Knepp dies or becomes disabled after providing notice of termination for good reason following a change in control, in which case, Mr. Knepp, or his estate, as the case may be, will be entitled to the amounts described above.

The agreement contains noncompete covenants which generally prohibit Mr. Knepp from engaging in banking activities within a county within the Commonwealth of Pennsylvania, or any contiguous county, in which a branch office or other facility of the Bank is located. These covenants generally extend for a period of one year after Mr. Knepp s termination of employment unless his employment terminates as a result of a delivery of a notice of nonrenewal by the Corporation and the Bank, in which case these covenants end on the date the agreement terminates.

**Ann M. Riles.** On February 28, 2011, Ms. Riles entered into an employment agreement with the Corporation and the Bank. The initial term of the agreement is three years and the agreement annually renews for a term ending one year from each annual anniversary date. Under the terms of the agreement, Ms. Riles will receive an annual base salary of at least $141,466, subject to increases by the Corporation and the Bank. Ms. Riles is also entitled to participate in any pension, retirement, profit sharing, stock option, incentive bonus, employee stock ownership, or other plans, benefits, and privileges available to employees and executive officers of the Corporation and the Bank.

The agreement may be terminated by the Corporation and the Bank for cause (as defined in the agreement), in which case the parties obligations under the agreement will cease. If the agreement is terminated by the Corporation and the Bank without cause and there has not been a change-in-control (as defined in the agreement), then the Corporation and the Bank will continue to pay Ms. Riles then current annual base salary for the number of months remaining in the term of his employment agreement and provide Ms. Riles, at no cost to her, with continuation

of health and medical benefits for a period of two years following termination of employment. In the event that health and medical benefits cannot be provided, a dollar amount equal to the after-tax cost of obtaining such benefits will be provided to Ms. Riles. If, following a change-in-control, the agreement is terminated by the Corporation and the Bank without cause or Ms. Riles voluntarily terminates her employment for good reason (as defined in the agreement), the Corporation or the Bank will pay Ms. Riles, in cash, within 30 days of termination, an aggregate amount equal to two times Ms. Riles then base salary; provided, however, that in the event the lump sum payment described above when added to all other amounts or benefits provided to Ms. Riles upon termination would result in the imposition of an excise tax under Section 4999 of the Code, the payment will be reduced to the extent necessary to avoid imposition of the tax. If during the term of the agreement, Ms. Riles voluntarily terminates employment, retires, dies, or becomes disabled (as defined in the agreement), the obligations of the parties under the agreement will cease, unless Ms. Riles dies or becomes disabled after providing notice of termination for good reason following a change in control, in which case, Ms. Riles, or her estate, as the case may be, will be entitled to the amounts described above.

The agreement contains noncompete covenants which generally prohibit Ms. Riles from engaging in banking activities within a county within the Commonwealth of Pennsylvania, or any contiguous county, in which a branch office or other facility of the Bank is located. These covenants generally extend for a period of one year after Ms. Riles termination of employment unless her employment terminates as

a result of a delivery of a notice of nonrenewal by the Corporation and the Bank, in which case these covenants end on the date the agreement terminates.

**COMPENSATION AND BENEFITS COMMITTEE REPORT**

The Committee has reviewed and discussed the foregoing Compensation Discussion and Analysis with management. Based on the Committee s review and discussion with management, the Committee has recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement and in, through incorporation by reference from this proxy statement, our Annual Report on Form 10-K for the year ended December 31, 2011.

**Members of the Compensation and Benefits Committee**
Michael J. Casale, Jr.
H. Thomas Davis, Jr.
D. Michael Hawbaker
R. Edward Nestlerode, Jr.

Notwithstanding anything to the contrary set forth in any of our previous filings under the Securities Act or the Exchange Act, that incorporate future filings, including this proxy statement, in whole or in part, the foregoing report shall not be incorporated by reference into any such filing.

**EXECUTIVE COMPENSATION**

The following table sets forth the annual compensation for services in all capacities to the Corporation and the Bank for the year ended December 31, 2011 for those persons who served as the principal executive officer or principal financial officer at any time during the last completed fiscal year (collectively, the named executive officers ). No other executive officer received total compensation in excess of $100,000 for the last completed fiscal year.

**Summary Compensation Table**

| Name and Principal Position | Year | Salary ($)(1) | Bonus ($)(2) | Stock Awards ($) | Option Awards ($) | Non-Equity Incentive Plan Compensation ($)(3) | Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(4) | All Other Compensation ($)(5)(6) | Total ($) |
|---|---|---|---|---|---|---|---|---|---|
| Richard A. Grafmyre | 2011 | $ 245,000 | $ 600 | $ | $ | $ 88,536 | $ | $ 26,223 | $ 360,359 |
| President and Chief Executive Officer (7) | 2010 | 38,635 | 100 | | | | | 190 | 38,925 |
| Brian L. Knepp | 2011 | 110,942 | 600 | | | 28,956 | | 8,377 | 148,875 |
| Chief Financial Officer (8) | 2010 | 105,320 | 600 | | | 19,969 | | 7,836 | 133,725 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2009 | 98,540 | 13,443 | | | 6,945 | 118,928 |
| Ann M. Riles | 2011 | 137,725 | 600 | 35,946 | 165,593 | 7,240 | 347,104 |
| Chief Credit Officer (9) | 2010 | 133,748 | 600 | 25,358 | 84,260 | 9,240 | 253,206 |
| | 2009 | 129,835 | 24,334 | | 40,260 | 6,096 | 200,525 |

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(1) Total includes base salary Mr. Grafmyre, Mr. Knepp, and Ms. Riles.

(2) Amounts for 2011 and 2010 represent $600 holiday bonus paid to all employees. Amounts for 2009 include discretionary cash bonuses paid prior to adoption of the Corporation s Performance-Based Bonus Plan in March 2010.

(3) Amounts represent amounts paid for 2011 and 2010 under the Corporation s Performance-Based Bonus Plan adopted in March 2010.

(4) The amounts in the Change in Pension Value and Nonqualified Deferred Compensation earnings column include the aggregate change in the actuarial present value of the accumulated benefit under the defined benefit pension plan. The pension plan is described under the heading Retirement Plan below.

(5) The cost of certain perquisites and other personal benefits for Mr. Knepp and Ms. Riles are not included because such total does not exceed $10,000. For Mr. Grafmyre, 2011 amounts include: club membership fees and dues $20,425; life insurance $1,120; and automobile $4,678.

(6) Other compensation includes employer contributions to the 401(k) Plan for the benefit of Mr. Grafmyre, Mr. Knepp, and Ms. Riles.

(7) Mr. Grafmyre joined the Corporation in October 2010 and serves as the President and Chief Executive Officer of the Corporation and the Bank, and is also a member of the Board of Directors of the Corporation and the Bank.

(8) Mr. Knepp serves as the Chief Financial Officer and Secretary of the Corporation and the Bank.

(9) Ms. Riles serves as a Senior Vice President of the Corporation and the Bank and the Chief Credit Officer of the Bank.

**GRANTS OF PLAN-BASED AWARDS**

There were no grants of equity plan-based awards to our named executive officers during the 2011 fiscal year.

The following table shows information regarding non-equity incentive awards under the Corporation s Performance-Based Bonus Plan for 2011 for Mr. Grafmyre, Mr. Knepp, and Ms. Riles.

**GRANTS OF PLAN-BASED AWARDS**

(For fiscal year ended December 31, 2011)

| | Estimated Future Payouts Under Non-Equity Incentive Plan Awards (1) | | |
|---|---|---|---|
| **Name** | **Threshold ($)** | **Target ($)** | **Maximum ($)** |
| Richard A. Grafmyre | $ 24,500 | $ 53,900 | $ 102,900 |
| Brian L. Knepp | 8,099 | 17,751 | 34,392 |
| Ann M. Riles | 10,027 | 21,977 | 42,581 |

(1) Amounts reported are the following percentages of base salary in 2011, based on achievement of weighted target results for 2011 (i.e., return on equity, gross loan growth, growth in deposits (excluding brokered deposits), growth in core deposits, net interest margin, and net overhead as percentage of average assets), which were established as targets by the Compensation and Benefits Committee under the Performance-Based Bonus Plan: Mr. Grafmyre - 10.0% (threshold), 22.0% (target), and 42.0% (maximum) and Mr. Knepp and Ms. Riles 7.3%, 16.0%, and 31.0%.

Awards were paid for 2011 under the Performance-Based Bonus Plan because actual performance measured against weighted performance factors resulted in performance of approximately 170% of targeted performance goals. Cash payments made under the Plan for 2011 are

included in the Summary Compensation Table under the column labeled Non-Equity Incentive Plan Compensation. For further information on the Performance-Based Bonus Plan, see the Compensation Discussion & Analysis section of this proxy statement.

**OUTSTANDING EQUITY AWARDS**

There were no outstanding equity awards as of December 31, 2011 for our named executive officers.

**OPTION EXERCISES AND STOCK VESTED**

There were no options exercised or vested during the 2011 fiscal year.

**NONQUALIFIED DEFERRED COMPENSATION**

There was no participation by any of the named executive officers in a nonqualified deferred compensation plan.

**RETIREMENT PLAN**

The Bank maintains a noncontributory defined benefit pension plan for all employees hired prior to January 1, 2004, who meet certain age and length of service requirements. Benefits are based primarily on years of service and the average annual compensation earned by an employee, which is the employee s annual compensation averaged over the five highest paid consecutive calendar years within the final ten years of employment. Annual compensation is based upon the employee s W-2 wages, which includes base salary, bonus, personal vehicle mileage for certain executive officers, and life insurance coverage that exceeds $50,000. The Bank s funding policy is consistent with the funding requirements of federal law and regulations. Plan assets are primarily comprised of common stocks and U.S. Government and corporate debt securities. The plan was amended, effective January 1, 2004, to cease eligibility for employees with a hire date of January 1, 2004 or later. Because Messrs. Grafmyre and Knepp joined the Bank in 2010 and 2005, respectively, they are not eligible to participate in the pension plan and are, therefore, excluded from the table below. Employees with a hire date of January 1, 2004 or later are eligible to receive, after one year of service, an annual contribution by the Bank equal to a discretionary percentage of an employee s base compensation into an account established for the employee under the Bank s 401(k) plan. The accrued normal retirement benefit under the plan is determined by the following formula: 1.4% of the average annual compensation up to social security covered compensation multiplied by the credited service, plus 2% of the average annual compensation that is in excess of the Social Security covered compensation multiplied by the number of years of credited service.

The following table sets forth the total number of years of credited service and the present value of the accumulated benefit as of December 31, 2011 for the named executive officer who participates in the defined benefit pension plan.

**Pension Benefits Table**

| Name | Plan Name | Number of Years Credited Service (#) | Present Value of Accumulated Benefit ($) | Payments During Last Fiscal Year ($) |
|---|---|---|---|---|
| Ann M. Riles | Jersey Shore State Bank Retirement Plan | 27.25 | $ 617,856 | $ |

**POTENTIAL POST-EMPLOYMENT PAYMENTS**

Each of Mr. Grafmyre, Mr. Knepp, and Ms. Riles will be entitled to certain contractual benefits if their employment terminates under certain circumstances preceding or following a change in control. The agreements are described under the caption Employment and Change-in-Control Agreements included in the Compensation Discussion and Analysis. We calculated the potential post-employment payments due to each of these named executive officers assuming each named executive officer terminated employment or a change in control occurred on December 31, 2011. Actual amounts payable can only be determined at the time of such executive s termination. The following table summarizes the potential payments to Mr. Grafmyre, Mr. Knepp, and Ms. Riles.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Richard A. Grafmyre** | Severance (1) | $ | $ | $ 447,050 | $ | $ 490,000 | $ 490,000 |
| | Welfare continuation (2) | | | 11,436 | | | |
| | Potential reduction in payout due to operation of Code Section 280G | | | | | | |
| | **Total** | **$** | **$** | **$ 458,486** | **$** | **$ 490,000** | **$ 490,000** |
| **Brian L. Knepp** | Severance (1) | $ | $ | $ 156,753 | $ | $ 240,112 | $ 240,112 |
| | Welfare continuation (2) | | | | | | |
| | Potential reduction in payout due to operation of Code Section 280G | | | | | | |
| | **Total** | **$** | **$** | **$ 156,753** | **$** | **$ 240,112** | **$ 240,112** |
| **Ann M. Riles** | Severance (1) | $ | $ | $ 159,589 | $ | $ 307,447 | $ 307,447 |
| | Welfare continuation (2) | | | 12,473 | | | |
| | Potential reduction in payout due to operation of Code Section 280G | | | | | | |
| | **Total** | **$** | **$** | **$ 172,062** | **$** | **$ 307,447** | **$ 307,447** |

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(1) For severance and welfare continuation payment calculation, and time and form of such payments, see Employment and Severance Agreements.
(2) Assumes no increase in the cost of welfare benefits.

**AUDIT COMMITTEE REPORT**

The Audit Committee of the Board of Directors is composed of four (4) independent directors as defined under NASDAQ listing standards. The Audit Committee operates under a written charter adopted by the Board of Directors, a copy of which is available on our website, www.jssb.com, under Investor Relations/Financial Information/Governance Documents and is available upon request to the President.

The Audit Committee has reviewed our audited financial statements for the fiscal year ended December 31, 2011, and discussed them with management and our independent registered public accounting firm, S.R. Snodgrass, A.C. The Audit Committee also has discussed with our independent auditor the matters required to be discussed by the U.S. Statement on Auditing Standards No. 61, as amended.

The Audit Committee has received from our independent auditor the written disclosures and letter required by the applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant s communications with the Audit Committee concerning independence and the Audit Committee has discussed with management and the independent accountant the accountant s independence.

Based on the review and discussions described above, the Audit Committee recommended to the Board of Directors that our audited financial statements for the fiscal year ended December 31, 2011 be included in our Annual Report on Form 10-K for that fiscal year for filing with the SEC.

In connection with standards for independence of our external auditors issued by the Public Company Accounting Oversight Board, during the 2012 fiscal year, the Audit Committee will undertake to consider in advance of the provision of any non-audit services by our independent accountant whether the provision of such services is compatible with maintaining the independence of our external auditors.

This report is not intended to be incorporated by reference into any filing made by Penns Woods Bancorp, Inc. with the SEC under the Securities Act or the Exchange Act.

**Members of the Audit Committee**
James M. Furey, II
D. Michael Hawbaker
Leroy H. Keiler, III
R. Edward Nestlerode, Jr.

**PROPOSAL NOS. 2 AND 3**
**AMENDMENT OF ARTICLES OF INCORPORATION TO INCREASE AUTHORIZED SHARES OF COMMON STOCK FROM 10,000,000 TO 15,000,000 AND AUTHORIZE 3,000,000 SHARES OF PREFERRED STOCK**

**General**

The Corporation presently is authorized to issue 10,000,000 shares of common stock, $8.33 par value per share, and no shares of preferred stock. The Corporation s Board of Directors recommends that shareholders approve amendments to Article 5 of the Corporation s articles of incorporation to (i) increase the authorized shares of common stock from 10,000,000 shares to 15,000,000 shares and (ii) authorize the issuance of 3,000,000 shares of preferred stock, commonly referred to as blank check preferred stock because the creation and issuance of the preferred stock is authorized by shareholders in advance and the specific terms, rights, and features of the preferred stock are determined by the Board of Directors from time to time. The authorization of blank check preferred stock would permit the Board of Directors to create and issue preferred stock from time to time in one or more classes or series. Subject to the Corporation s articles of incorporation, as amended from time to time, and the limitations prescribed by law or by any stock exchange or national securities association trading system on which the Corporation s securities may be listed, the Board of Directors would be expressly authorized, at its discretion, to adopt resolutions to issue preferred shares, to fix the number of shares, and to change designations, preferences, and relative, participating, optional or other special rights, qualifications, limitations or restrictions thereof, including dividend rights, dividend rates,

terms of redemption, redemption prices, voting rights, conversion rights, and liquidation preferences of the shares constituting any series of preferred stock, in each case without any further action or vote by shareholders.

The Board of Directors has unanimously approved the proposed amendments to the Corporation s articles of incorporation, subject to shareholder approval, and directed that such amendments be submitted to the Corporation s shareholders for approval.

**Rationale for Increasing Shares of Common Stock and Authorizing Preferred Stock**

The Board of Directors believes that the proposed amendments to the articles of incorporation will provide the Corporation with increased flexibility in meeting future capital requirements by both increasing the authorized common stock and providing another type of security in addition to its common stock for use in connection with corporate activities. Such uses may include, without limitation, issuance as all or part of the consideration to be paid by the Corporation for strategic acquisitions of other businesses should appropriate opportunities arise in the future, issuance for cash as a means of obtaining additional capital to meet regulatory requirements or fund organic growth, or use in connection with employee benefit plans. The Board of Directors also believes that the global economic challenges experienced over the past few years, and the challenges experienced by the financial services industry in particular, may result in both increased regulatory capital requirements in the future and also present the opportunity to make targeted strategic acquisitions that complement the Corporation s business and operations. The Board believes that the availability of additional shares of common stock and shares of preferred stock (which can be customized to meet the needs of any particular transaction or market conditions) to address any such requirements or opportunities is advisable. The Corporation is not a party to any agreement, arrangement, or understanding relating to an acquisition of another entity as of the date of this proxy statement.

**Effect of Amendment on Current Shareholders**

If the proposed amendments are approved by the shareholders, the additional common stock and preferred stock so authorized could be issued, at the discretion of the Board of Directors, for any proper corporate purpose, without further action by the shareholders other than as may be required by applicable law or stock exchange listing standards for a particular transaction. Existing shareholders do not have preemptive rights with respect to future issuances of common stock or preferred stock by the Corporation and their interest in the Corporation could be diluted by such issuances with respect to any of the following: earnings per share, voting, liquidation rights, and book and market value.

If the proposed amendment with respect to the increase in authorized common stock is approved, each additional share of common stock authorized for issuance will have the same rights as, and is identical in all respects with, each other share of the Corporation s common stock. The newly authorized shares of common stock will not affect the rights, such as voting and liquidation rights, of the shares of common stock currently outstanding.

If the proposed amendment with respect to the preferred stock is approved, the Board of Directors will have the power to issue the authorized preferred stock in one or more classes or series with such preferences and voting rights as the Board of Directors may fix in the resolution providing for the issuance of such shares. The issuance of preferred stock could affect the relative rights of the Corporation s common stock. Depending upon the exact terms, limitations, and relative rights and preferences, if any of the preferred stock as determined by the Board of Directors at the time of issuance, the holders of preferred stock may be entitled to a higher dividend rate than that paid on the common stock, a prior claim on funds available for the payment of dividends, a fixed preferential payment in the event of liquidation and dissolution of the Corporation, redemption rights, rights to convert their preferred stock into common stock, and voting rights which would tend to dilute the voting control of the Corporation by the holders of common stock. Depending on the particular terms of any series of the preferred stock, holders thereof may have significant voting rights and the right to representation on the Corporation s Board of Directors. In addition, the

approval of the holders of preferred stock, voting as a class or as a series, may be required for the taking of certain corporate actions, such as mergers or similar transactions.

**Possible Anti-Takeover Effects of Proposed Amendment to Articles of Incorporation**

The issuance of common stock or preferred stock may have the effect of discouraging or thwarting persons seeking to take control of the Corporation through a tender offer, proxy fight, or otherwise seeking to bring about removal of incumbent management or a corporate transaction such as a merger even if a shareholder or group of shareholders supported any such transaction. For example, the issuance of common or preferred stock in a public or private sale, merger or in a similar transaction would increase the number of the Corporation s outstanding shares, thereby diluting the interest of a party seeking to acquire control of the Corporation. Further, the preferred stock may be viewed as having the effect of discouraging an attempt by another person or entity to acquire control of the Corporation because the blank check preferred stock could be used by the Board of Directors for defensive measures, including the issuance of shares of preferred stock to dilute the economic interest or voting power of the person or entity seeking to acquire control or the adoption of a shareholder rights plan or so-called poison pill. The proposed amendments have not been made in response to, and are not being presented to deter, any effort to obtain control of the Corporation and are not being proposed as anti-takeover measures.

**Text of Proposed Amendment to Articles of Incorporation**

If both proposals are approved by shareholders, Article 5 of the Corporation s Articles of Incorporation will be amended will to read in its entirety as follows:

5. The corporation shall have authority to issue (i) fifteen million (15,000,000) shares of common stock, par value $8.33 per share, and (ii) three million (3,000,000) shares of preferred stock, having such par value as the Board of Directors shall fix and determine (the Preferred Stock ). The Preferred Stock may be issued from time to time as a class without series or, if so determined by the Board of Directors of the corporation, either in whole or in part, in one or more series. There is hereby expressly granted to and vested in the Board of Directors of the corporation authority to fix and determine (except as fixed and determined herein), by resolution, the par value, voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, if any, and the qualifications, limitations or restrictions thereof, if any, including specifically, but not limited to, the dividend rights, conversion rights, redemption rights and liquidation preferences, if any, of any wholly unissued series of Preferred Stock (or the entire class of Preferred Stock if none of such shares have been issued), the number of shares constituting any such series and the terms and conditions of the issue thereof. Prior to the issuance of any shares of Preferred Stock, a statement setting forth a copy of each such resolution or resolutions and the number of shares of Preferred Stock of each such class or series shall be executed and filed in accordance with the Pennsylvania Business Corporation Law. Unless otherwise provided in any such resolution or resolutions, the number of shares of capital stock of any such class or series so set forth in such resolution or resolutions may thereafter be increased or decreased (but not below the number of shares then outstanding), by a statement likewise executed and filed setting forth a statement that a specified increase or decrease therein had been authorized and directed by a resolution or resolutions likewise adopted by the Board of Directors of the corporation. In case the number of such shares shall be decreased, the number of shares so specified in the statement shall resume the status they had prior to the adoption of the first resolution or resolutions.

If Proposal No. 2 is approved, the articles of incorporation will be amended to increase the authorized number of shares of common stock from 10,000,000 to 15,000,000. If Proposal No. 3 is approved, the articles of incorporation will be amended to authorize the issuance of 3,000,000 shares of preferred stock. Approval of Proposal No. 2 and Proposal No. 3 are not dependent on approval of the other by shareholders.

THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE FOR THE PROPOSALS TO AMEND THE ARTICLES OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK FROM 10,000,000 TO 15,000,000 AND TO AUTHORIZE 3,000,000 SHARES OF PREFERRED STOCK. The affirmative vote of a majority of all votes cast at the Annual Meeting is required to approve each of Proposals 2 and 3. All proxies will be voted FOR each of Proposals 2 and 3 unless a shareholder specifies to the contrary on such shareholder s proxy card.

**PROPOSAL NO. 4**
**RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors of the Corporation has appointed the firm of S.R. Snodgrass, A.C., Certified Public Accountants (the Auditors ), of Wexford, Pennsylvania, as the Corporation s independent registered public accounting firm for its 2012 fiscal year. The terms of the appointment were reviewed and recommended by the Audit Committee.

Although ratification by the Corporation s shareholders is not required by our bylaws or otherwise, the Board of Directors is submitting the selection of the Auditors to shareholders for ratification because the Corporation values its shareholders views on the Corporation s independent

registered public accounting firm. If the Corporation s shareholders fail to ratify the selection, it will be considered as notice to the Board of Directors and the Audit Committee to consider the selection of a different independent registered public accounting firm. Even if the selection is ratified, the Audit Committee in its discretion may select a different independent registered public accounting firm at any time during the year if it determines that such a change would be in the best interests of the Corporation.

A representative from the Auditors is expected to be present at the Annual Meeting. The representative will be given an opportunity to make a statement if he or she desires to do so, and will be available to answer appropriate questions from shareholders.

The Auditors served as the Corporation s independent registered public accounting firm for the 2011 and 2010 fiscal years, provided assistance to the Corporation and the Bank in connection with regulatory matters, charging the Bank for such services at its customary hourly billing rates. The fees paid by the Corporation and Bank are summarized below. The non-audit services were approved by the Corporation s and the Bank s Audit Committee after due consideration of the effect of the performance thereof on the independence of the Auditors and after the conclusions by the Corporation s and the Bank s Board of Directors that there was no effect on the independence of the Auditors. The Auditors have advised the Corporation that none of its members have any financial interest in the Corporation.

**Audit Fees**

The fees for professional services incurred by the Corporation for services rendered by the Corporation s independent auditors in connection with the audit of the Corporation s financial statements for the years ended December 31, 2011 and December 31, 2010, and the review of the Corporation s Forms 10-Q for such fiscal years were $117,459 and $113,650, respectively. All such services were performed by permanent, full-time employees of S.R. Snodgrass, A.C.

**Audit-Related Fees**

Audit-Related fees for the performance of the audits of the Bank s employee benefit plans financial statements for the years ended December 31, 2011 and December 31, 2010, were $20,818 and $19,066, respectively.

**Tax Fees**

Tax fees for the years ended December 31, 2011 and December 31, 2010 resulting from services provided by the Corporation s independent registered public accounting firm totaled $15,726 and $16,300, respectively.

**Other Fees**

There were no other fees billed to the Corporation and Bank by S.R. Snodgrass, A.C. for other services for the years ended

December 31, 2011 and December 31, 2010.

**Pre-approval of Audit and Permissible Non-Audit Services**

The Audit Committee of the Board of Directors pre-approves all audit and permissible non-audit services provided by the Corporation s independent registered public accounting firm. All of the services provided by S.R. Snodgrass, A.C. set forth above were pre-approved by the Audit Committee.

THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE FOR RATIFICATION FOR THE APPOINTMENT OF S.R. SNODGRASS, A.C., AS THE CORPORATION S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE 2012 FISCAL YEAR. The affirmative vote of a majority of all votes cast at the Annual Meeting is required to ratify the appointment. All proxies will be voted FOR ratification appointment unless a shareholder specifies to the contrary on such shareholder s proxy card.

**SHAREHOLDER PROPOSALS FOR 2013 ANNUAL MEETING**

SEC Regulations permit shareholders to submit proposals for consideration at annual meetings of shareholders. Any such proposals for the Corporation s Annual Meeting of Shareholders to be held in 2013 must be submitted in writing to the President of Penns Woods Bancorp, Inc., at its principal executive office, 300 Market Street, Williamsport, PA 17701, on or before November 21, 2012, and must follow the procedures required by SEC Rule 14a-8 in order to be included in proxy materials relating to that meeting.

A shareholder proposal submitted after November 21, 2012, or which does not otherwise meet the requirements of the SEC, will not be included in the Corporation s proxy statement for the annual meeting to be held in 2013, but may be presented for consideration at the annual meeting, if submitted to the Secretary of the Corporation not less than ninety (90) days or more than one hundred fifty (150) days prior to the annual meeting, which proposal must contain certain information required by the Bylaws. If the shareholder intending to present such a proposal has not provided the Corporation written notice of the matter on or before January 25, 2013, the proxy holders of the Board of Directors will have discretionary authority to vote on such proposal at the meeting. However, if the date of the 2013 annual meeting is changed more than 30 days from April 25, 2013, the anniversary of the 2012 annual meeting, the deadline for delivery notice to the Corporation which would restrict the proxy holders of the Board of Directors from exercising discretion would be a reasonable time before the Corporation sends its proxy materials, assuming the notice complies with the requirements of the Bylaws.

**CERTAIN TRANSACTIONS**

NASDAQ rules require that we conduct an appropriate review of related party transactions for potential conflict of interest situations on an ongoing basis, and all such transactions must be approved by our Audit Committee or another independent body of the Board of Directors.

Our Code of Ethics and Conflicts of Interest Policy requires all directors, officers, and employees who may have a potential or apparent conflict of interest to notify our Human Resource Director. A potential conflict exists whenever an individual has an outside interest direct or indirect which conflicts with the individual s duty to the Corporation or any of its affiliates or adversely affects the individual s judgment in the discharge of his or her responsibilities. Prior to consideration, full disclosure of all material facts concerning the

relationship and financial interest of the relevant individuals in the transaction is required The Code of Ethics and Conflict of Interest Policy is available for review by contacting the President.

To identify related party transactions, each year, we submit and require our directors and officers to complete Director and Officer Questionnaires identifying any transaction with us or any of our subsidiaries in which the officer or director or their family members have an interest.

There have been no material transactions between the Corporation and the Bank, or any material transactions proposed, with any director or executive officer of the Corporation and the Bank, or any associate of the foregoing persons. The Corporation and the Bank have had, and intend to continue to have, banking and financial transactions in the ordinary course of business with directors and officers of the Corporation and the Bank and their associates on comparable terms and with similar interest rates as those prevailing from time to time for persons not related to or associated with the Corporation and the Bank.

Total loans outstanding from the Bank at December 31, 2011 to the Corporation s and the Bank s officers and directors as a group and members of their immediate families and companies in which they had an ownership interest of 10% or more was $8,644,000 or approximately 12.75% of the total equity capital of the Bank. Loans to such persons were made in the ordinary course of business, were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not related to the Corporation and the Bank, and did not involve more than the normal risk of collectability or present other unfavorable features.

**ANNUAL REPORT**

A copy of the Corporation s Annual Report and Form 10-K for its fiscal year ended December 31, 2011 is enclosed with this proxy statement.

You may access the following proxy materials at http://www.cfpproxy.com/4823:

- Notice of the 2012 Annual Meeting of Shareholders;
- the 2012 Proxy Statement of the Corporation;
- the Corporation s Annual Report to Shareholders for the year ended December 31, 2011; and
- Proxy Card.

## OTHER MATTERS

The Board of Directors of the Corporation is not aware that any other matters are to be presented for action, other than the matters described in the accompanying Notice of Annual Meeting of Shareholders. Because the Corporation has not received notice of any other matters to be presented for action at the meeting; if any other matters properly come before the Meeting, or any adjournments thereof, the proxy holders are authorized to vote thereon at their discretion.

All directors of the Corporation are expected to attend the Corporation s Annual Meeting of Shareholders. In 2011, eight directors attended the Annual Meeting of Shareholders.

Shareholders may communicate directly with the Board of Directors of the Corporation by contacting the Corporation s President & Chief Executive Officer, Richard A. Grafmyre, 300 Market Street, Williamsport, PA 17701 (570-322-1111). All bona fide communications received by the Corporation s President & Chief Executive Officer will be relayed to the applicable member of the Board of Directors or, if no specific director is designated to receive the communication, the appropriate board member.

## ADDITIONAL INFORMATION

UPON WRITTEN REQUEST OF ANY SHAREHOLDER, A COPY OF THE CORPORATION S REPORT ON FORM 10-K FOR ITS FISCAL YEAR ENDED DECEMBER 31, 2011 INCLUDING THE FINANCIAL STATEMENTS AND THE SCHEDULES THERETO,

REQUIRED TO BE FILED WITH THE SEC PURSUANT TO RULE 13a-1 UNDER THE EXCHANGE ACT MAY BE OBTAINED, WITHOUT CHARGE, FROM RICHARD A. GRAFMYRE, PRESIDENT, PENNS WOODS BANCORP, INC.

By Order of the Board of Directors,

Richard A. Grafmyre
President and Chief Executive Officer

Dated: March 21, 2012



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