CITIZENS FINANCIAL SERVICES INC
Form 10-Q
November 06, 2014

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

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

For the quarterly period ended September 30, 2014
Or

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

For the transition period from_____________________ to ___________________

Commission file number 0-13222

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes __X__ No_____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ____ Accelerated filer _X__

Non-accelerated filer ____ Smaller reporting company ____
(Do not check if a smaller reporting company)

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

The number of outstanding shares of the Registrant's Common Stock, as of October 28, 2014, was 3,041,904.

Citizens Financial Services, Inc.
Form 10-Q

INDEX

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

(in thousands except share data)		September 30 2014		December 31 2013
ASSETS:				
Cash and due from banks:				
Noninterest-bearing	$	10,889	$	8,899
Interest-bearing		434		1,184
Total cash and cash equivalents		11,323		10,083
Interest bearing time deposits with other banks		5,712		2,480
Available-for-sale securities		308,283		317,301
Loans held for sale		753		278
Loans (net of allowance for loan losses: 2014, $6,816 and 2013, $7,098)		536,939		533,514
Premises and equipment		11,773		11,105
Accrued interest receivable		3,689		3,728
Goodwill		10,256		10,256
Bank owned life insurance		15,045		14,679
Other assets		9,272		11,510
TOTAL ASSETS	$	913,045	$	914,934
LIABILITIES:				
Deposits:				
Noninterest-bearing	$	94,049	$	85,585
Interest-bearing		673,993		662,731
Total deposits		768,042		748,316
Borrowed funds		37,729		66,932
Accrued interest payable		753		895
Other liabilities		7,361		6,735
TOTAL LIABILITIES		813,885		822,878
STOCKHOLDERS' EQUITY:				
Preferred Stock				
$1.00 par value; authorized 3,000,000 shares September 30, 2014 and December 31, 2013; none issued in 2014 or 2013		-		-
Common stock				
$1.00 par value; authorized 15,000,000 shares; issued 3,335,236 at September 30, 2014 and 3,305,517 at December 31, 2013		3,335		3,306
Additional paid-in capital		25,140		23,562

Retained earnings		77,252		74,325
Accumulated other comprehensive income (loss)		1,513		(1,225)
Treasury stock, at cost: 293,332 shares at September 30, 2014				
and 290,468 shares at December 31, 2013		(8,080)		(7,912)
TOTAL STOCKHOLDERS' EQUITY		99,160		92,056
TOTAL LIABILITIES AND				
STOCKHOLDERS' EQUITY	$	913,045	$	914,934

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

1

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

(in thousands, except share and per share data)	Three Months Ended September 30 2014	Three Months Ended September 30 2013	Nine Months Ended September 30 2014	Nine Months Ended September 30 2013
INTEREST INCOME:				
Interest and fees on loans	$ 7,094	$ 7,521	$ 21,200	$ 21,799
Interest-bearing deposits with banks	25	8	51	27
Investment securities:				
Taxable	805	905	2,542	2,804
Nontaxable	844	850	2,526	2,563
Dividends	40	23	159	61
TOTAL INTEREST INCOME	8,808	9,307	26,478	27,254
INTEREST EXPENSE:				
Deposits	1,092	1,279	3,291	3,894
Borrowed funds	142	283	451	951
TOTAL INTEREST EXPENSE	1,234	1,562	3,742	4,845
NET INTEREST INCOME	7,574	7,745	22,736	22,409
Provision for loan losses	150	90	480	315
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,424	7,655	22,256	22,094
NON-INTEREST INCOME:				
Service charges	1,098	1,145	3,239	3,313
Trust	151	169	528	539
Brokerage and insurance	141	120	398	333
Investment securities gains, net	242	91	488	385
Gains on loans sold	40	75	110	236
Earnings on bank owned life insurance	124	127	366	377
Other	128	124	337	328
TOTAL NON-INTEREST INCOME	1,924	1,851	5,466	5,511
NON-INTEREST EXPENSES:				
	2,790	2,856	8,600	8,456

Salaries and employee benefits								
Occupancy		313		302		967		956
Furniture and equipment		86		157		280		372
Professional fees		289		187		731		604
FDIC insurance		116		112		345		337
Pennsylvania shares tax		101		183		485		548
Other		1,372		1,168		3,750		3,411
TOTAL NON-INTEREST EXPENSES		5,067		4,965		15,158		14,684
Income before provision for income taxes		4,281		4,541		12,564		12,921
Provision for income taxes		913		1,029		2,655		2,842
NET INCOME	$	3,368	$	3,512	$	9,909	$	10,079
PER COMMON SHARE DATA:								
Net Income - Basic	$	1.11	$	1.15	$	3.26	$	3.29
Net Income - Diluted	$	1.11	$	1.15	$	3.26	$	3.29
Cash Dividends Paid	$	1.000	$	0.281	$	1.772	$	0.829
Number of shares used in computation - basic		3,035,214		3,054,226		3,038,973		3,059,520
Number of shares used in computation - diluted		3,036,700		3,055,709		3,040,400		3,060,808

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2014	2013	2014	2013
Net income	$ 3,368	$ 3,512	$ 9,909	$ 10,079
Other comprehensive income (loss):				
Change in unrealized gains on available for sale securities	855	(183)	4,598	(8,215)
Income tax effect	(291)	62	(1,563)	2,793
Change in unrecognized pension cost	13	66	38	194
Income tax effect	(4)	(22)	(13)	(66)
Change in unrealized loss on interest rate swap	-	53	-	154
Income tax effect	-	(18)	-	(52)
Less: Reclassification adjustment for investment security gains included in net income	(242)	(91)	(488)	(385)
Income tax effect	82	30	166	130
Other comprehensive income (loss), net of tax	413	(103)	2,738	(5,447)
Comprehensive income	$ 3,781	$ 3,409	$ 12,647	$ 4,632

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

3

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

(in thousands)	Nine Months Ended September 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 9,909	$ 10,079
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	480	315
Depreciation and amortization	358	318
Amortization and accretion of investment securities	1,632	1,837
Deferred income taxes	562	570
Investment securities gains, net	(488)	(385)
Earnings on bank owned life insurance	(366)	(377)
Originations of loans held for sale	(8,055)	(17,039)
Proceeds from sales of loans held for sale	7,690	18,473
Realized gains on loans sold	(110)	(236)
Decrease in accrued interest receivable	39	1
Decrease in accrued interest payable	(142)	(172)
Other, net	(222)	(495)
Net cash provided by operating activities	11,287	12,889
CASH FLOWS FROM INVESTING ACTIVITIES:		
Available-for-sale securities:		
Proceeds from sales	17,338	15,894
Proceeds from maturity and principal repayments	39,416	64,380
Purchase of securities	(44,769)	(98,526)
Purchase of interest bearing time deposits with other banks	(3,232)	(2,480)
Proceeds from redemption of regulatory stock	2,891	1,186
Purchase of regulatory stock	(1,895)	(563)
Net increase in loans	(4,680)	(19,800)

Purchase of premises and equipment		(555)		(339)
Proceeds from sale of foreclosed assets held for sale		647		151
Net cash provided by (used in) investing activities		5,161		(40,097)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net increase in deposits		19,726		21,560
Proceeds from long-term borrowings		6,815		-
Repayments of long-term borrowings		(4,200)		(10,800)
Net (decrease) increase in short-term borrowed funds		(31,818)		7,837
Purchase of treasury and restricted stock		(733)		(1,431)
Dividends paid		(4,998)		(2,535)
Net cash (used) provided by financing activities		(15,208)		14,631
Net (decrease) increase in cash and cash equivalents		1,240		(12,577)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		10,083		26,333
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	11,323	$	13,756
Supplemental Disclosures of Cash Flow Information:				
Interest paid	$	3,884	$	5,017
Income taxes paid	$	2,085	$	2,945
Loans transferred to foreclosed property	$	867	$	62
Premises and equipment transferred from other assets	$	549	$	-

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

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

Note 1 - Basis of Presentation

Citizens Financial Services, Inc. (individually and collectively with its direct and indirect subsidiaries, the “Company”) is a Pennsylvania corporation organized as the holding company of its wholly owned subsidiary, First Citizens Community Bank (the “Bank”), and the Bank’s subsidiary, First Citizens Insurance Agency, Inc. (“First Citizens Insurance”).

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission (“SEC”) and in conformity with U.S. generally accepted accounting principles. Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. Certain of the prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no effect on net income or stockholders’ equity. All material inter-company balances and transactions have been eliminated in consolidation.

In the opinion of management of the Company, the accompanying interim financial statements for the periods ended September 30, 2014 and 2013 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the period. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. The financial performance reported for the Company for the nine month period ended September 30, 2014 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

Note 2 - Earnings per Share

The following table sets forth the computation of earnings per share. Earnings per share calculations give retroactive effect to stock dividends declared by the Company.

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net income applicable to common stock	$3,368,000	$3,512,000	$9,909,000	$10,079,000
Basic earnings per share computation				
Weighted average common shares outstanding	3,035,214	3,054,226	3,038,973	3,059,520
Earnings per share - basic	$1.11	$1.15	$3.26	$3.29
Diluted earnings per share computation				
Weighted average common shares outstanding for basic	3,035,214	3,054,226	3,038,973	3,059,520

earnings per share				
Add: Dilutive effects of restricted stock	1,486	1,483	1,427	1,288
Weighted average common shares outstanding for dilutive earnings per share	3,036,700	3,055,709	3,040,400	3,060,808
Earnings per share - diluted	$1.11	$1.15	$3.26	$3.29

For the three months ended September 30, 2014 and 2013, there were 1,938 and 1,037 shares, respectively, related to the restricted stock program that were excluded from the diluted earnings per share calculations since they were anti-dilutive. These anti-dilutive shares had prices ranging from $34.70-$50.50 for the three month period ended September 30 2014 and prices ranging from $36.00-$44.50 for the three month period ended September 30, 2013. For the nine months ended September 30, 2014 and 2013, 2,913 and 3,280 shares, respectively, related to the restricted stock program were excluded from the diluted earnings per share calculations since they were anti-dilutive. These anti-dilutive shares had prices ranging from $34.70-$50.50 for the nine month period ended September 30, 2014 and prices ranging from $34.70-$44.50 for the nine month period ended September 30, 2013.

Note 3 - Income Tax Expense

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

Note 4 – Investments

The amortized cost and fair value of investment securities at September 30, 2014 and December 31, 2013 were as follows (in thousands):

September 30, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agency securities	$ 146,993	$ 503	$ (1,011)	$ 146,485
U.S. treasury securities	11,873	-	(343)	11,530
Obligations of state and political subdivisions	96,830	3,784	(191)	100,423
Corporate obligations	13,923	250	(73)	14,100
Mortgage-backed securities in government sponsored entities	33,581	486	(85)	33,982
Equity securities in financial institutions	1,136	647	(20)	1,763
Total available-for-sale securities	$ 304,336	$ 5,670	$ (1,723)	$ 308,283
December 31, 2013				
Available-for-sale securities:				
U.S. agency securities	$ 153,896	$ 702	$ (2,409)	$ 152,189
U.S. treasury securities	11,856	-	(547)	11,309
Obligations of state and political subdivisions	94,113	2,146	(1,254)	95,005

Corporate obligations		16,651		341		(190)		16,802
Mortgage-backed securities in government sponsored entities		40,405		566		(300)		40,671
Equity securities in financial institutions		542		783		-		1,325
Total available-for-sale securities	$	317,463	$	4,538	$	(4,700)	$	317,301

The following table shows the Company's gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time, which individual securities have been in a continuous unrealized loss position, at September 30, 2014 and December 31, 2013 (in thousands). As of September 30, 2014, the Company owned 76 securities whose fair value was less than their cost basis.

September 30, 2014	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. agency securities	$ 49,419	$ (202)	$ 43,395	$ (809)	$ 92,814	$ (1,011)
U.S. treasury securities	-	-	11,530	(343)	11,530	(343)
Obligations of state and political subdivisions	2,324	(18)	11,431	(173)	13,755	(191)
Corporate obligations	505	(2)	7,781	(71)	8,286	(73)
Mortgage-backed securities in government sponsored entities	2,309	(5)	4,733	(80)	7,042	(85)
Equity securities in financial institutions	581	(20)	-	-	581	(20)
Total securities	$ 55,138	$ (247)	$ 78,870	$ (1,476)	$ 134,008	$ (1,723)
December 31, 2013						
U.S. agency securities	$ 98,356	$ (2,212)	$ 2,825	$ (197)	$ 101,181	$ (2,409)
U.S. treasury securities	11,309	(547)	-	-	11,309	(547)
Obligations of states and political subdivisions	24,201	(865)	6,491	(389)	30,692	(1,254)
Corporate obligations	6,103	(124)	2,251	(66)	8,354	(190)
Mortgage-backed securities in government sponsored entities	23,920	(266)	1,164	(34)	25,084	(300)
Total securities	$ 163,889	$ (4,014)	$ 12,731	$ (686)	$ 176,620	$ (4,700)

As of September 30, 2014, the Company's investment securities portfolio contained unrealized losses on agency securities issued or backed by the full faith and credit of the United States government or are generally viewed as having the implied guarantee of the U.S. government, U.S treasuries, obligations of states and political subdivisions, corporate obligations, mortgage backed securities in government sponsored entities and equity securities in financial institutions. For fixed maturity investments management considers whether the present value of cash flows expected to be collected are less than the security's amortized cost basis (the difference defined as the credit loss), the magnitude and duration of the decline, the reasons underlying the decline and the Company's intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value, to determine whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, if the Company does not intend to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings. For equity securities where the fair value has been significantly below cost for one year, the Company's policy is to recognize an impairment loss unless sufficient evidence is available that the decline is not other than temporary and a recovery period can be predicted. The Company has concluded that any impairment of its investment securities portfolio outlined in the above table is not other than temporary and is the result of interest rate changes, sector credit rating changes, or company-specific rating changes that are not expected to result in the non-collection of principal and interest during the period.

Proceeds from sales of securities available-for-sale for the nine months ended September 30, 2014 and 2013 were $17,338,000 and $15,894,000, respectively. For the three months ended September 30, 2014 and 2013, there were sales of $5,187,000 and $121,000, respectively, of available-for-sale securities. The gross gains and losses were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Gross gains	$ 242	$ 91	$ 488	$ 525
Gross losses	-	-	-	(140)
Net gains	$ 242	$ 91	$ 488	$ 385

Investment securities with an approximate carrying value of $189.1 million and $194.7 million at September 30, 2014 and December 31, 2013, respectively, were pledged to secure public funds and certain other deposits.

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The amortized cost and fair value of debt securities at September 30, 2014, by contractual maturity, are shown below (in thousands):

	Amortized Cost	Fair Value
Available-for-sale debt securities:		
Due in one year or less	$ 11,726	$ 11,879
Due after one year through five years	129,401	129,523
Due after five years through ten years	61,345	61,461
Due after ten years	100,728	103,657
Total	$ 303,200	$ 306,520

Note 5 – Loans

The Company grants loans primarily to customers throughout North Central Pennsylvania and Southern New York. Although the Company had a diversified loan portfolio at September 30, 2014 and December 31, 2013, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within these regions. The following table summarizes the primary segments of the loan portfolio and how those segments are analyzed within the allowance for loan losses as of September 30, 2014 and December 31, 2013 (in thousands):

September 30, 2014	Total Loans	Individually evaluated for impairment	Collectively evaluated for impairment
Real estate loans:			
Residential	$ 187,315	$ 324	$ 186,991
Commercial and agricultural	211,888	6,333	205,555

Construction		4,960		-	4,960
Consumer		8,798		-	8,798
Other commercial and agricultural loans		56,664		1,942	54,722
State and political subdivision loans		74,130		-	74,130
Total		543,755	$	8,599 $	535,156
Allowance for loan losses		6,816			
Net loans	$	536,939			

December 31, 2013	Total Loans	Individually evaluated for impairment	Collectively evaluated for impairment
Real estate loans:			
Residential	$ 187,101	$ 342	$ 186,759
Commercial and agricultural	215,088	8,310	206,778
Construction	8,937	-	8,937
Consumer	9,563	15	9,548
Other commercial and agricultural loans	54,029	1,733	52,296
State and political subdivision loans	65,894	-	65,894
Total	540,612	$ 10,400	$ 530,212
Allowance for loan losses	7,098		
Net loans	$ 533,514		

The segments of the Bank’s loan portfolio are disaggregated into classes to a level that allows management to monitor risk and performance. Residential real estate mortgages consists primarily of 15 to 30 year first mortgages on residential real estate, while residential real estate home equity loans are consumer purpose installment loans or lines of credit secured by a mortgage which is often a second lien on residential real estate with terms of 15 years or less. Commercial real estate loans are business purpose loans secured by a mortgage on commercial real estate. Agricultural real estate loans are loans secured by a mortgage on real estate used in agriculture production. Construction real estate loans are loans secured by residential or commercial real estate used during the construction phase of residential and commercial projects. Consumer loans are typically unsecured or primarily secured by something other than real estate and overdraft lines of credit connected with customer deposit accounts. Other commercial loans are loans for commercial purposes primarily secured by non-real estate collateral. Other agricultural loans are loans for agricultural purposes primarily secured by non-real estate collateral. State and political subdivisions are loans for state and local municipalities for capital and operating expenses or tax free loans used to finance commercial development.

Management considers commercial loans, other agricultural loans, state and political subdivision loans, commercial real estate loans and agricultural real estate loans which are 90 days or more past due to be impaired. Management will also consider a loan impaired based on other factors it becomes aware of, including the customer’s results of operations and cash flows or if the loan is modified in a troubled debt restructuring. In addition, certain residential mortgages, home equity and consumer loans that are cross collateralized with commercial relationships that are determined to be impaired may also be classified as impaired. Impaired loans are analyzed to determine if it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allocation of the allowance for loan losses or a charge-off to the allowance for loan losses.

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables by class, with the associated allowance amount, if applicable (in thousands):

9

September 30, 2014	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Real estate loans:					
Mortgages	$ 224	$ 128	$ 67	$ 195	$ 13
Home Equity	131	63	66	129	12
Commercial	8,584	5,456	877	6,333	97
Agricultural	-	-	-	-	-
Construction	-	-	-	-	-
Consumer	-	-	-	-	-
Other commercial loans	2,020	1,188	754	1,942	36
Other agricultural loans	-	-	-	-	-
State and political subdivision loans	-	-	-	-	-
Total	$ 10,959	$ 6,835	$ 1,764	$ 8,599	$ 158
December 31, 2013					
Real estate loans:					
Mortgages	$ 232	$ 138	$ 70	$ 208	$ 14
Home Equity	134	65	69	134	13
Commercial	9,901	6,335	1,975	8,310	305
Agricultural	-	-	-	-	-
Construction	-	-	-	-	-
Consumer	15	15	-	15	-
Other commercial loans	1,794	1,679	54	1,733	1
Other agricultural loans	-	-	-	-	-
State and political subdivision loans	-	-	-	-	-
Total	$ 12,076	$ 8,232	$ 2,168	$ 10,400	$ 333

The following tables includes the average balance of impaired financing receivables by class and the income recognized on impaired loans for the three and nine month periods ended September 30, 2014 and 2013(in thousands):

	For the Nine Months ended					
	September 30, 2014			September 30, 2013		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis
Real estate loans:						
Mortgages	$ 201	$ 7	$ -	$ 336	$ 6	$ -
Home Equity	131	3	-	136	3	-
Commercial	7,616	66	-	8,521	426	361
Agricultural	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Consumer	13	-	-	2	-	-
Other commercial loans	1,982	61	-	1,740	58	-
Other agricultural loans	-	-	-	-	-	-
State and political subdivision loans	-	-	-	-	-	-
Total	$ 9,943	$ 137	$ -	$ 10,735	$ 493	$ 361

10

	For the Three Months Ended					
	September 30, 2014			September 30, 2013		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis
Real estate loans:						
Mortgages	$ 197	$ 3	$ -	$ 349	$ 2	$ -
Home Equity	130	1	-	135	1	-
Commercial	6,770	22	-	8,372	342	326
Agricultural	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Consumer	10	-	-	5	-	-
Other commercial loans	1,943	15	-	1,647	17	-
Other agricultural loans	-	-	-	-	-	-
State and political subdivision loans	-	-	-	-	-	-
Total	$ 9,050	$ 41	$ -	$ 10,508	$ 362	$ 326

Credit Quality Information

For commercial real estate, agricultural real estate, construction, other commercial, other agricultural and state and political subdivision loans, management uses a nine point internal risk rating system to monitor the credit quality. The first five categories are considered not criticized and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The definitions of each rating are defined below:

- Pass (Grades 1-5) – These loans are to customers with credit quality ranging from an acceptable to very high quality and are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral.
- Special Mention (Grade 6) – This loan grade is in accordance with regulatory guidance and includes loans where a potential weakness or risk exists, which could cause a more serious problem if not corrected.
- Substandard (Grade 7) – This loan grade is in accordance with regulatory guidance and includes loans that have a well-defined weakness based on objective evidence and be characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
-

Doubtful (Grade 8) – This loan grade is in accordance with regulatory guidance and includes loans that have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances.

- Loss (Grade 9) – This loan grade is in accordance with regulatory guidance and includes loans that are considered uncollectible, or of such value that continuance as an asset is not warranted.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay loan as agreed, the Bank's loan rating process includes several layers of internal and external oversight. The Company's loan officers are responsible for the timely and accurate risk rating of the loans in each of their portfolios at origination and on an ongoing basis under the supervision of management. All commercial, agricultural and municipal loans are reviewed annually to ensure the appropriateness of the loan grade. In addition, the Bank engages an external consultant on at least an annual basis. The external consultant is engaged to 1) review a minimum of 55% of the dollar volume of the commercial loan portfolio on an annual basis, 2) review new loans over $1.0 million originated in the last year, 3) review a majority of relationships in aggregate over $1.0 million, 4) review selected aggregate loan relationships over $750,000 which are over 30 days past due classified Special Mention, Substandard, Doubtful, or Loss, and 5) such other loans which management or the consultant deems appropriate.

The following tables represent credit exposures by internally assigned grades as of September 30, 2014 and December 31, 2013 (in thousands):

September 30, 2014	Pass	Special Mention	Substandard	Doubtful	Loss	Ending Balance
Real estate loans:						
Commercial	$ 165,424	$ 8,993	$ 13,275	$ -	$ -	$ 187,692
Agricultural	19,109	2,963	2,124	-	-	24,196
Construction	4,960	-	-	-	-	4,960
Other commercial loans	36,982	4,996	3,160	7	-	45,145
Other agricultural loans	9,597	452	1,470	-	-	11,519
State and political subdivision loans	74,130	-	-	-	-	74,130
Total	$ 310,202	$ 17,404	$ 20,029	$ 7	$ -	$ 347,642
December 31, 2013						
Real estate loans:						
Commercial	$ 166,956	$ 4,645	$ 21,284	$ 202	$ -	$ 193,087
Agricultural	15,923	1,910	4,168	-	-	22,001
Construction	8,937	-	-	-	-	8,937
Other commercial loans	40,798	1,747	1,938	5	-	44,488
Other agricultural loans	7,431	153	1,957	-	-	9,541
State and political subdivision loans	65,894	-	-	-	-	65,894
Total	$ 305,939	$ 8,455	$ 29,347	$ 207	$ -	$ 343,948

For residential real estate mortgages, home equity and consumer loans, credit quality is monitored based on whether the loan is performing or non-performing, which is typically based on the aging status of the loan and payment activity, unless a specific action, such as bankruptcy, repossession, death or significant delay in payment occurs to raise awareness of a possible credit event. Non-performing loans include those loans that are considered nonaccrual, described in more detail below and all loans past due 90 or more days and still accruing. The following table presents the recorded investment in those loan classes based on payment activity as of September 30, 2014 and December 31, 2013 (in thousands):

September 30, 2014	Performing	Non-performing	Total
Real estate loans:			
Mortgages	$ 122,393	$ 991	$ 123,384
Home Equity	63,577	354	63,931
Consumer	8,748	50	8,798
Total	$ 194,718	$ 1,395	$ 196,113
December 31, 2013			
Real estate loans:			
Mortgages	$ 119,075	$ 809	$ 119,884
Home Equity	66,989	228	67,217
Consumer	9,547	16	9,563
Total	$ 195,611	$ 1,053	$ 196,664

Age Analysis of Past Due Financing Receivables

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table includes an aging analysis of the recorded investment of past due financing receivables as of September 30, 2014 and December 31, 2013 (in thousands):

September 30, 2014	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Financing Receivables	90 Days and Accruing
Real estate loans:							
Mortgages	$ 277	$ 196	$ 807	$ 1,280	$ 122,104	$ 123,384	$ 257
Home Equity	505	51	330	886	63,045	63,931	175
Commercial	484	22	1,309	1,815	185,877	187,692	331
Agricultural	42	-	-	42	24,154	24,196	-
Construction	-	-	-	-	4,960	4,960	-
Consumer	53	3	-	56	8,742	8,798	-
Other commercial loans	21	-	343	364	44,781	45,145	-
Other agricultural loans	-	-	-	-	11,519	11,519	-
State and political subdivision loans	-	-	-	-	74,130	74,130	-
Total	$ 1,382	$ 272	$ 2,789	$ 4,443	$ 539,312	$ 543,755	$ 763

Loans considered non-accrual	$ 81	$ 22	$ 2,026	$ 2,129	$ 4,622	$ 6,751
Loans still accruing	1,301	250	763	2,314	534,690	537,004
Total	$ 1,382	$ 272	$ 2,789	$ 4,443	$ 539,312	$ 543,755

December 31, 2013							
Real estate loans:							
Mortgages	$ 362	$ 40	$ 739	$ 1,141	$ 118,743	$ 119,884	$ 301
Home Equity	632	2	229	863	66,354	67,217	51
Commercial	88	319	3,091	3,498	189,589	193,087	344
Agricultural	-	-	-	-	22,001	22,001	-
Construction	-	-	-	-	8,937	8,937	-

Consumer	96	36	16	148	9,415	9,563	1
Other commercial loans	29	28	49	106	44,382	44,488	-
Other agricultural loans	-	-	-	-	9,541	9,541	-
State and political subdivision loans	-	-	-	-	65,894	65,894	-
Total	$ 1,207	$ 425	$ 4,124	$ 5,756	$ 534,856	$ 540,612	$ 697

Loans considered non-accrual	$ 98	$ 164	$ 3,427	$ 3,689	$ 4,408	$ 8,097
Loans still accruing	1,109	261	697	2,067	530,448	532,515
Total	$ 1,207	$ 425	$ 4,124	$ 5,756	$ 534,856	$ 540,612

Nonaccrual Loans

Loans are considered for non-accrual status upon reaching 90 days delinquency, although the Company may be receiving partial payments of interest and partial repayments of principal on such loans or if full payment of principal and interest is not expected. Additionally, if management is made aware of other information including bankruptcy, repossession, death, or legal proceedings, the loan may be placed on non-accrual status. If a loan is 90 days or more past due and is well secured and in the process of collection, it may still be considered accruing.

The following table reflects the financing receivables on non-accrual status as of September 30, 2014 and December 31, 2013, respectively. The balances are presented by class of financing receivable (in thousands):

	September 30, 2014	December 31, 2013
Real estate loans:		
Mortgages	$ 734	$ 508
Home Equity	179	177
Commercial	5,003	7,247
Agricultural	-	-
Construction	-	-
Consumer	50	15
Other commercial loans	785	150
Other agricultural loans	-	-
State and political subdivision	-	-
	$ 6,751	$ 8,097

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial difficulties, management may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a Troubled Debt Restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring by calculating the present value of the revised loan terms and comparing this balance to the Company’s investment in the loan prior to the restructuring. As these loans are individually evaluated, they are excluded from pooled portfolios when calculating the allowance for loan and lease losses and a separate allocation within the allowance for loan and lease losses is provided. Management continually evaluates loans that are considered TDRs, including payment history under the modified loan terms, the borrower’s ability to continue to repay the loan based on continued evaluation of their operating results and cash flows from operations. Based on this evaluation management would no longer consider a loan to be a TDR when the relevant facts support such a conclusion. As of September 30, 2014 and December 31, 2013, included within the allowance for loan losses are reserves of $29,000 and $28,000 respectively, that are associated with loans modified as TDRs.

There were no loan modifications that were considered TDRs during the three months ended September 30, 2014 or 2013. Loan modifications that are considered TDRs completed during the nine months ended September 30, 2014 and 2013 were as follows (dollars in thousands):

	For the Nine months Ended September 30, 2014		
	Number of contracts	Pre-modification Outstanding Recorded Investment	Post-Modification Outstanding

					Recorded Investment	
	Interest Modification	Term Modification	Interest Modification	Term Modification	Interest Modification	Term Modification
Real estate loans:						
Commercial	-	2	$ -	$ 153	$ -	$ 153
Total	-	2	$ -	$ 153	$ -	$ 153

14

	For the Nine months Ended September 30, 2013					
	Number of contracts		Pre-modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
	Interest Modification	Term Modification	Interest Modification	Term Modification	Interest Modification	Term Modification
Real estate loans:						
Mortgages	1	-	$ 72	$ -	$ 72	$ -
Commercial	-	2	-	1,365	-	1,365
Other commercial loans	-	2	-	1,530	-	1,530
Total	1	4	$ 72	$ 2,895	$ 72	$ 2,895

Recidivism, or the borrower defaulting on its obligation pursuant to a modified loan, results in the loan once again becoming a non-accrual loan. Recidivism occurs at a notably higher rate than do defaults on new origination loans, so modified loans present a higher risk of loss than do new origination loans. The following table presents the recorded investment in loans that were modified as TDRs during each 12-month period prior to the current reporting periods, which begin January 1, 2014 and 2013 (nine month periods) and July 1, 2014 and 2013 (3 month periods), respectively, and that subsequently defaulted during these reporting periods (dollars in thousands):

	For the Three Months Ended				For the Nine months Ended			
	September 30, 2014		September 30, 2013		September 30, 2014		September 30, 2013	
	Number of contracts	Recorded investment	Number of contracts	Recorded investment	Number of contracts	Recorded investment	Number of contracts	Recorded investment
Real estate loans:								
Commercial	-	$ -	-	$ -	1	$ 483	-	$ -
Total recidivism	-	$ -	-	$ -	1	$ 483	-	$ -

Allowance for Loan Losses

The following table segregates the allowance for loan losses (ALLL) into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of September 30, 2014 and December 31, 2013, respectively (in thousands):

	September 30, 2014			December 31, 2013		
	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
Real estate loans:						
Residential	$ 25	$ 861	$ 886	$ 27	$ 919	$ 946
Commercial and agricultural	97	3,606	3,703	305	4,253	4,558

Construction	-	23	23	-	50	50
Consumer	-	86	86	-	105	105
Other commercial and agricultural loans	36	1,127	1,163	1	941	942
State and political subdivision loans	-	450	450	-	330	330
Unallocated	-	505	505	-	167	167
Total	$ 158	$ 6,658	$ 6,816	$ 333	$ 6,765	$ 7,098

The following tables roll forward the balance of the ALLL by portfolio segment for the three and nine month periods ended September 30, 2014 and 2013, respectively (in thousands):

	Balance at June 30, 2014	Charge-offs	Recoveries	Provision	Balance at September 30, 2014
Real estate loans:					
Residential	$ 879	$ -	$ -	$ 7	$ 886
Commercial and agricultural	3,809	(11)	4	(99)	3,703
Construction	13	-	-	10	23
Consumer	86	(26)	6	20	86
Other commercial and agricultural loans	1,151	(58)	-	70	1,163
State and political subdivision loans	455	-	-	(5)	450
Unallocated	358	-	-	147	505
Total	$ 6,751	$ (95)	$ 10	$ 150	$ 6,816

	Balance at December 31, 2013	Charge-offs	Recoveries	Provision	Balance at September 30, 2014
Real estate loans:					
Residential	$ 946	$ (45)	$ -	$ (15)	$ 886
Commercial and agricultural	4,558	(486)	9	(378)	3,703
Construction	50	-	-	(27)	23
Consumer	105	(40)	21	-	86
Other commercial and agricultural loans	942	(221)	-	442	1,163
State and political subdivision loans	330	-	-	120	450
Unallocated	167	-	-	338	505
Total	$ 7,098	$ (792)	$ 30	$ 480	$ 6,816

	Balance at June 30, 2013	Charge-offs	Recoveries	Provision	Balance at September 30, 2013
Real estate loans:					
Residential	$ 934	$ (2)	$ 1	$ 23	$ 956
Commercial and agricultural	4,240	-	-	172	4,412
Construction	91	-	-	21	112
Consumer	114	(12)	5	7	114
Other commercial and agricultural loans	957	(1)	-	8	964
State and political subdivision loans	310	-	-	3	313

Unallocated		343		-		-		(144)		199
Total	$	6,989	$	(15)	$	6	$	90	$	7,070

	Balance at December 31, 2012		Charge-offs		Recoveries		Provision		Balance at September 30, 2013
Real estate loans:									
Residential	$	875	$	(15)	$	3	$	93	$	956
Commercial and agricultural		4,437		-		-		(25)		4,412
Construction		38		-		-		74		112
Consumer		119		(42)		26		11		114
Other commercial and agricultural loans		728		(1)		-		237		964
State and political subdivision loans		271		-		-		42		313
Unallocated		316		-		-		(117)		199
Total	$	6,784	$	(58)	$	29	$	315	$	7,070

The Company allocates the ALLL based on the factors described below, which conform to the Company's loan classification policy and credit quality measurements. In reviewing risk within the Bank's loan portfolio, management has determined there to be several different risk categories within the loan portfolio. The ALLL consists of amounts applicable to: (i) residential real estate loans; (ii) residential real estate home equity loans; (iii) commercial real estate loans; (iv) agricultural real estate loans; (v) real estate construction loans; (vi) other commercial and agricultural loans; (vii) consumer loans; (viii) other agricultural loans and (ix) state and political subdivision loans. Factors considered in this process include general loan terms, collateral, and availability of historical data to support the analysis. Historical loss percentages are calculated and used as the basis for calculating allowance allocations. Certain qualitative factors are evaluated to determine additional inherent risks in the loan portfolio, which are not necessarily reflected in the historical loss percentages. These factors are then added to the historical allocation percentage to get the adjusted factor to be applied to non-classified loans. The following qualitative factors are analyzed:

- Level of and trends in delinquencies, impaired/classified loans
  Change in volume and severity of past due loans
  Volume of non-accrual loans
  Volume and severity of classified, adversely or graded loans;
- Level of and trends in charge-offs and recoveries;
- Trends in volume, terms and nature of the loan portfolio;
- Effects of any changes in risk selection and underwriting standards and any other changes in lending and recovery policies, procedures and practices;
- Changes in the quality of the Bank's loan review system;
- Experience, ability and depth of lending management and other relevant staff;
- National, state, regional and local economic trends and business conditions
  General economic conditions
  Unemployment rates
  Inflation / Consumer Price Index
  Changes in values of underlying collateral for collateral-dependent loans;
- Industry conditions including the effects of external factors such as competition, legal, and regulatory requirements on the level of estimated credit losses; and
- Existence and effect of any credit concentrations, and changes in the level of such concentrations.
- Any change in the level of board oversight

The Company also maintains an unallocated allowance to account for any factors or conditions that may cause a potential loss but are not specifically addressed in the process described above. The Company analyzes its loan portfolio each quarter to determine the appropriateness of its allowance for loan losses.

Loans determined to be TDRs are impaired and for purposes of estimating the ALLL must be individually evaluated for impairment. In calculating the impairment, the Company calculates the present value utilizing an analysis of discounted cash flows. If the present value calculated is below the recorded investment of the loan, impairment is recognized by a charge to the provision for loan and lease losses and a credit to the ALLL.

We continually review the model utilized in calculating the required allowance. The following qualitative factors experienced changes during the first nine months of 2014:

- The qualitative factor for national, state, regional and local economic trends and business conditions was decreased for all loan categories due to a decrease in the unemployment rates in the local and state economy.
- The qualitative factors for changes in levels of and trends in delinquencies, impaired/classified loans were decreased for commercial and agricultural real estate due to the decrease in the Company's classified loans to its lowest level in three years and a decrease in the amount of loans past due.

- The qualitative factors for changes in levels of and trends in delinquencies, impaired/classified loans were increased for other commercial loans due to an increase in classified loans during 2014.
- The qualitative factor for levels of and trends in charge-offs and recoveries was increased for commercial real estate and other commercial loans due to the increase in charge-offs compared to historical norms for the Bank.
- The qualitative factor for experience, ability and depth of lending management and other relevant staff was decreased for all loan categories due to the length of time employees involved throughout the loan process have been in their positions.
- The qualitative factor for industry conditions, including the effects of external factors such as competition, legal, and regulatory requirements on the level of estimated credit losses was decreased for agricultural related loans due to the improvement in the agricultural economy during 2014.

The following qualitative factors experienced changes during the three months ended September 30, 2014:

- The qualitative factor for levels of and trends in charge-offs and recoveries was increased for commercial real estate and other commercial loans due to the increase in charge-offs compared to historical norms for the Bank.
- The qualitative factors for changes in levels of and trends in delinquencies, impaired/classified loans were decreased for other commercial loans real estate due to the decrease in the amount of loans past due as of September 30, 2014.
- The qualitative factor for industry conditions, including the effects of external factors such as competition, legal, and regulatory requirements on the level of estimated credit losses was decreased for agricultural related loans due to the improvement in the agricultural economy during 2014.

The primary factor that resulted in negative provisions for certain portfolio segments for the three and nine month periods is due to decreases in the outstanding balances for certain portfolio segments compared to December 31, 2013, a reduction in the amount of substandard loans and the decrease in the qualitative factor associated with the improvement in unemployment rates noted above.

The following qualitative factors experienced changes during the first nine months of 2013:

- The qualitative factor for national, state, regional and local economic trends and business conditions was increased for all loan categories due to rising unemployment rates in the local economy as a result of the slowdown in Marcellus shale natural gas exploration activities.
- The qualitative factor for trends in volume, terms and nature of the loan portfolio was increased for commercial and agricultural real estate, other commercial and agricultural loans and state and political subdivision loan categories due to the increase of the number of loans that are participations that were purchased from other banks and therefore subject to different underwriting standards.
- The qualitative factor for the existence and effect of any credit concentrations and changes in the level of such concentrations was increased for other commercial and agricultural loans and was lowered for commercial and agricultural real estate as the loan growth has slowed in 2013.

During the third quarter of 2013, there were no significant changes in any qualitative factor. As a result, the change in the allocation of the allowance from June 30, 2013, is mainly attributable to the changes in the loan portfolio balances since that date and the change in the loan grades. The increase in the allowance related to commercial and agricultural real estate in the third quarter was primarily the result of the increase during the period in substandard loans of $2.1 million dollars that were not individually evaluated for impairment.

Note 6 – Federal Home Loan Bank Stock

The Bank is a member of the FHLB of Pittsburgh and as such, is required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB. As of September 30, 2014 and December 31, 2013, the Bank holds $2,656,400 and $3,652,100, respectively. The stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated by management. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) A significant decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. Management considered that the FHLB's regulatory capital ratios have improved, liquidity appears adequate, new shares of FHLB stock continue to exchange hands at the $100 par value and the FHLB has repurchased shares of excess capital stock from its members and has pays a quarterly cash dividend.

Note 7 - Employee Benefit Plans

For additional detailed disclosure on the Company's pension and employee benefits plans, please refer to Note 11 of the Company's Consolidated Financial Statements included in the 2013 Annual Report on Form 10-K.

Noncontributory Defined Benefit Pension Plan

The Bank sponsors a noncontributory defined benefit pension plan (“Pension Plan”) covering substantially all employees and officers. The Bank’s funding policy is to make annual contributions, if needed, based upon the funding formula developed by the plan’s actuary. Any employee with a hire date of January 1, 2007 or later is not eligible to participate in the Pension Plan. In lieu of the Pension Plan, employees with a hire date of January 1, 2007 or later are eligible to receive, after meeting certain length of service requirements, an annual discretionary 401(k) plan contribution from the Bank equal to a percentage of an employee’s base compensation. The contribution amount, if any, is placed in a separate account within the 401(k) plan and is subject to a vesting requirement.

For employees who are eligible to participate in the Pension Plan, the Pension Plan requires benefits to be paid to eligible employees based primarily upon age and compensation rates during employment. Upon retirement or other termination of employment, employees can elect either an annuity benefit or a lump sum distribution of vested benefits in the Pension Plan.

The following sets forth the components of net periodic benefit costs of the Pension Plan for the three and nine months ended September 30, 2014 and 2013, respectively (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013