

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

(Address of principal executive offices)

(Zip Code)

(570) 322-1111

Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES 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 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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Small 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

On November 4, 2009 there were 3,833,764 shares of the Registrant's common stock outstanding.

Table of Contents

PENNS WOODS BANCORP, INC.

INDEX TO QUARTERLY REPORT ON FORM 10-Q

	Page Number
<u>Part I</u> <u>Financial Information</u>	
<u>Item 1.</u> <u>Financial Statements</u>	
<u>Consolidated Balance Sheet (unaudited) as of September 30, 2009 and December 31, 2008</u>	<u>3</u>
<u>Consolidated Statement of Income (unaudited) for the Three and Nine Months ended September 30, 2009 and 2008</u>	<u>4</u>
<u>Consolidated Statement of Changes in Shareholders' Equity (unaudited) for the Nine Months ended September 30, 2009 and 2008</u>	<u>5</u>
<u>Consolidated Statement of Comprehensive Income (unaudited) for the Three and Nine Months ended September 30, 2009 and 2008</u>	<u>5</u>
<u>Consolidated Statement of Cash Flows (unaudited) for the Nine Months ended September 30, 2009 and 2008</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements (unaudited)</u>	<u>7</u>
<u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>22</u>
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>41</u>
<u>Item 4.</u> <u>Controls and Procedures</u>	<u>41</u>
<u>Part II</u> <u>Other Information</u>	
<u>Item 1.</u> <u>Legal Proceedings</u>	<u>42</u>
<u>Item 1A.</u> <u>Risk Factors</u>	<u>42</u>
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>42</u>
<u>Item 3.</u> <u>Defaults Upon Senior Securities</u>	<u>42</u>
<u>Item 4.</u> <u>Submission of Matters to a Vote of Security Holders</u>	<u>42</u>
<u>Item 5.</u> <u>Other Information</u>	<u>42</u>
<u>Item 6.</u> <u>Exhibits</u>	<u>43</u>
<u>Signatures</u>	<u>44</u>
<u>Exhibit Index and Exhibits</u>	<u>45</u>

Table of Contents**Part I. FINANCIAL INFORMATION****Item 1. Financial Statements**PENNS WOODS BANCORP, INC.
CONSOLIDATED BALANCE SHEET

(UNAUDITED)

(In Thousands, Except Share Data)

	September 30, 2009	December 31, 2008
ASSETS		
Noninterest-bearing balances	\$ 12,633	\$ 16,563
Interest-bearing deposits in other financial institutions	30	18
Total cash and cash equivalents	12,663	16,581
Investment securities, available for sale, at fair value	219,404	208,251
Investment securities held to maturity (fair value of \$111 and \$136)	110	135
Loans held for sale	5,403	3,622
Loans	400,825	381,478
Less: Allowance for loan losses	4,478	4,356
Loans, net	396,347	377,122
Premises and equipment, net	7,791	7,865
Accrued interest receivable	3,515	3,614
Bank-owned life insurance	15,023	14,546
Investment in limited partnerships	5,040	4,727
Goodwill	3,032	3,032
Deferred tax asset	6,907	10,879
Other assets	3,450	2,429
TOTAL ASSETS	\$ 678,685	\$ 652,803
LIABILITIES		
Interest-bearing deposits	\$ 414,493	\$ 345,333
Noninterest-bearing deposits	75,569	76,035
Total deposits	490,062	421,368
Short-term borrowings	21,440	73,946
Long-term borrowings, Federal Home Loan Bank (FHLB)	86,778	86,778
Accrued interest payable	1,191	1,317
Other liabilities	8,675	8,367
TOTAL LIABILITIES	608,146	591,776
SHAREHOLDERS EQUITY		
Common stock, par value \$8.33, 10,000,000 shares authorized; 4,012,519 and 4,010,528 shares issued	33,437	33,421
Additional paid-in capital	17,995	17,959
Retained earnings	26,481	28,177
Accumulated other comprehensive gain (loss):		

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

Net unrealized gain (loss) on available for sale securities	2,670	(8,486)
Defined benefit plan	(3,780)	(3,780)
Less: Treasury stock at cost, 179,028 and 179,028 shares	(6,264)	(6,264)
TOTAL SHAREHOLDERS EQUITY	70,539	61,027
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 678,685	\$ 652,803

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF INCOME

(UNAUDITED)

(In Thousands, Except Per Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
INTEREST AND DIVIDEND INCOME				
Loans including fees	\$ 6,457	\$ 6,311	\$ 19,025	\$ 18,936
Investment securities:				
Taxable	1,368	1,391	4,105	3,857
Tax-exempt	1,253	1,205	3,748	3,641
Dividend and other interest income	35	201	165	658
TOTAL INTEREST AND DIVIDEND INCOME	9,113	9,108	27,043	27,092
INTEREST EXPENSE				
Deposits	2,148	2,410	6,357	7,502
Short-term borrowings	82	310	318	996
Long-term borrowings, FHLB	938	875	2,781	3,044
TOTAL INTEREST EXPENSE	3,168	3,595	9,456	11,542
NET INTEREST INCOME	5,945	5,513	17,587	15,550
PROVISION FOR LOAN LOSSES	270	110	582	230
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,675	5,403	17,005	15,320
NON-INTEREST INCOME				
Service charges	553	594	1,619	1,704
Securities losses, net	(507)	(1,504)	(4,962)	(1,717)
Earnings on bank-owned life insurance	144	121	418	367
Gain on sale of loans	305	314	526	678
Insurance commissions	287	416	988	1,482
Other	599	531	1,624	1,493
TOTAL NON-INTEREST INCOME	1,381	472	213	4,007
NON-INTEREST EXPENSE				
Salaries and employee benefits	2,588	2,355	7,665	7,275
Occupancy, net	299	315	956	967
Furniture and equipment	293	304	906	876
Pennsylvania shares tax	171	105	514	315
Amortization of investment in limited partnerships	142	178	425	534
Other	1,604	1,194	4,161	3,440
TOTAL NON-INTEREST EXPENSE	5,097	4,451	14,627	13,407
INCOME BEFORE INCOME TAX (BENEFIT) PROVISION	1,959	1,424	2,591	5,920
INCOME TAX (BENEFIT) PROVISION	37	(128)	(1,002)	180
NET INCOME	\$ 1,922	\$ 1,552	\$ 3,593	\$ 5,740
EARNINGS PER SHARE - BASIC	\$ 0.50	\$ 0.40	\$ 0.94	\$ 1.49

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

EARNINGS PER SHARE - DILUTED	\$	0.50	\$	0.40	\$	0.94	\$	1.49
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC		3,833,131		3,855,348		3,832,471		3,865,317
WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED		3,833,305		3,855,458		3,832,555		3,865,463
DIVIDENDS PER SHARE	\$	0.46	\$	0.46	\$	1.38	\$	1.38

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(UNAUDITED)

(In Thousands, Except Per Share Data)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE LOSS	TREASURY STOCK	TOTAL SHAREHOLDERS EQUITY
	SHARES	AMOUNT					
Balance, December 31, 2008	4,010,528	\$ 33,421	\$ 17,959	\$ 28,177	\$ (12,266)	\$ (6,264)	\$ 61,027
Comprehensive income:							
Net income				3,593			3,593
Other comprehensive income					11,156		11,156
Dividends declared (\$1.38 per share)				(5,289)			(5,289)
Common shares issued for employee stock purchase plan	1,991	16	36				52
Balance, September 30, 2009	4,012,519	\$ 33,437	\$ 17,995	\$ 26,481	\$ (1,110)	\$ (6,264)	\$ 70,539

(In Thousands, Except Per Share Data)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE LOSS	TREASURY STOCK	TOTAL SHAREHOLDERS EQUITY
	SHARES	AMOUNT					
Balance, December 31, 2007	4,006,934	\$ 33,391	\$ 17,888	\$ 27,707	\$ (3,534)	\$ (4,893)	\$ 70,559
Cumulative effect of change in accounting for postretirement benefits							
				(437)			(437)
Comprehensive loss:							
Net income				5,740			5,740
Other comprehensive loss					(10,188)		(10,188)
Dividends declared, (\$1.38 per share)				(5,330)			(5,330)
Stock options exercised	330	3	8				11
Common shares issued for employee stock purchase plan	2,282	19	48				67
Purchase of treasury stock (27,726 shares)						(861)	(861)
Balance, September 30, 2008	4,009,546	\$ 33,413	\$ 17,944	\$ 27,680	\$ (13,722)	\$ (5,754)	\$ 59,561

PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(UNAUDITED)

(In Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net Income	\$ 1,922	\$ 1,552	\$ 3,593	\$ 5,740

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

Other comprehensive income (loss):

Change in net unrealized gains (losses) on available for sale securities	13,119	(8,301)	11,941	(17,153)
Less: Reclassification adjustment for net losses included in net income	(507)	(1,504)	(4,962)	(1,717)
Other comprehensive income (loss) before tax expense (benefit)	13,626	(6,797)	16,903	(15,436)
Income tax expense (benefit) related to other comprehensive income (loss)	4,633	(2,311)	5,747	(5,248)
Other comprehensive income (loss), net of tax	8,993	(4,486)	11,156	(10,188)
Comprehensive income (loss)	\$ 10,915	\$ (2,934)	\$ 14,749	\$ (4,448)

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

(In Thousands)

Nine Months Ended
September 30,
2009 2008

OPERATING ACTIVITIES				
Net Income	\$	3,593	\$	5,740
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		541		490
Provision for loan losses		582		230
Accretion and amortization of investment security discounts and premiums		(1,052)		(982)
Securities losses, net		4,962		1,717
Originations of loans held for sale		(24,448)		(31,276)
Proceeds of loans held for sale		23,193		31,181
Gain on sale of loans		(526)		(678)
Earnings on bank-owned life insurance		(418)		(367)
Other, net		(1,169)		(1,445)
Net cash provided by operating activities		5,258		4,610
INVESTING ACTIVITIES				
Investment securities available for sale:				
Proceeds from sales		5,377		39,994
Proceeds from calls and maturities		7,596		5,905
Purchases		(10,963)		(49,733)
Investment securities held to maturity:				
Proceeds from calls and maturities		25		179
Net increase in loans		(20,728)		(11,458)
Acquisition of bank premises and equipment		(467)		(1,551)
Proceeds from the sale of foreclosed assets				79
Purchase of bank-owned life insurance		(59)		(715)
Investment in limited partnership		(738)		
Proceeds from redemption of regulatory stock				3,663
Purchases of regulatory stock		(170)		(2,802)
Net cash used for investing activities		(20,127)		(16,439)
FINANCING ACTIVITIES				
Net increase in interest-bearing deposits		69,160		42,634
Net decrease in noninterest-bearing deposits		(466)		(1,085)
Proceeds of long-term borrowings, FHLB				10,000
Repayment of long-term borrowings, FHLB				(29,600)
Net decrease in short-term borrowings		(52,506)		(6,886)
Dividends paid		(5,289)		(5,330)
Issuance of common stock		52		67
Stock options exercised				11
Purchase of treasury stock				(861)
Net cash provided by financing activities		10,951		8,950
NET DECREASE IN CASH AND CASH EQUIVALENTS		(3,918)		(2,879)
CASH AND CASH EQUIVALENTS, BEGINNING		16,581		15,433
CASH AND CASH EQUIVALENTS, ENDING	\$	12,663	\$	12,554

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

Interest paid	\$	9,582	\$	11,915
Income taxes paid		1,175		1,425
Transfer of loans to foreclosed real estate		921		297

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

PENNS WOODS BANCORP, INC. AND SUBSIDIARIES

NOTES TO

CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The consolidated financial statements include the accounts of Penns Woods Bancorp, Inc. (the Company) and its wholly-owned subsidiaries: Woods Investment Company, Inc., Woods Real Estate Development Company, Inc., and Jersey Shore State Bank (the Bank) and its wholly-owned subsidiary, The M Group, Inc. D/B/A The Comprehensive Financial Group (The M Group). All significant inter-company balances and transactions have been eliminated in the consolidation.

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The interim financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary for the fair presentation of results for such periods. The results of operations for any interim period are not necessarily indicative of results for the full year. These financial statements should be read in conjunction with financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

The accounting policies followed in the presentation of interim financial results are the same as those followed on an annual basis. These policies are presented on pages 38 through 44 of the Annual Report on Form 10-K for the year ended December 31, 2008.

In reference to the attached financial statements, all adjustments are of a normal recurring nature pursuant to Rule 10-01(b) (8) of Regulation S-X.

Note 2. Recent Accounting Pronouncements

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

In April 2009, the FASB issued new guidance impacting ASC Topic 820, *Fair Value Measurements and Disclosures*. This ASC provides additional guidance in determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. The adoption of this new guidance did not have a material effect on the Company's results of operations or financial position.

In April 2009, the FASB issued new guidance impacting ASC 825-10-50, *Financial Instruments*, which relates to fair value disclosures for any financial instruments that are not currently reflected on the balance sheet of companies at fair value. This guidance amended existing GAAP to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this new guidance did not have a material impact on the Company's financial position or results of operations.

Table of Contents

In April 2009, the FASB issued new guidance impacting ASC 320-10, *Investments - Debt and Equity Securities*, which provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities. This guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this new guidance did not have a material impact on the Company's financial position.

In June 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-01, *Topic 105 - Generally Accepted Accounting Principles - FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. The Codification is the single source of authoritative nongovernmental U.S. generally accepted accounting principles (GAAP). The Codification does not change current GAAP, but is intended to simplify user access to all authoritative GAAP by providing all the authoritative literature related to a particular topic in one place. Rules and interpretive releases of the SEC under federal securities laws are also sources of authoritative GAAP for SEC registrants. The Company adopted this standard for the interim reporting period ending September 30, 2009. The adoption of this standard did not have a material impact on the Company's results of operations or financial position.

In June 2009, the FASB issued an accounting standard related to the accounting for transfers of financial assets, which is effective for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. This standard enhances reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. This standard eliminates the concept of a qualifying special-purpose entity and changes the requirements for derecognizing financial assets. This standard also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. This accounting standard was subsequently codified into ASC Topic 860. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In June 2009, the FASB issued FAS No. 167, *Amendments to FASB Interpretation No. 46(R)*. FAS 167, which amends FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, (FIN 46(R)). Under FASB's Codification at ASC 105-10-65-1-d, FAS No. 167 will remain authoritative until integrated into the FASB Codification. This statement prescribes a qualitative model for identifying whether a company has a controlling financial interest in a variable interest entity (VIE) and eliminates the quantitative model prescribed by FIN 46(R). The new model identifies two primary characteristics of a controlling financial interest: (1) provides a company with the power to direct significant activities of the VIE, and (2) obligates a company to absorb losses of and/or provides rights to receive benefits from the VIE. FAS No. 167 requires a company to reassess on an ongoing basis whether it holds a controlling financial interest in a VIE. A company that holds a controlling financial interest is deemed to be the primary beneficiary of the VIE and is required to consolidate the VIE. This statement is effective for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

Table of Contents

In August 2009, the FASB issued ASU No. 2009-05, *Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value*. This ASU provides amendments for fair value measurements of liabilities. It provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more techniques. ASU 2009-05 also clarifies that when estimating a fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. ASU 2009-05 is effective for the first reporting period (including interim periods) beginning after issuance or fourth quarter 2009. The Company is currently evaluating the impact of this standard on the Company's financial condition, results of operations, and disclosures.

Note 3. Per Share Data

There are no convertible securities which would affect the denominator in calculating basic and dilutive earnings per share. Net income as presented on the consolidated statement of income will be used as the numerator. The following table sets forth the composition of the weighted average common shares (denominator) used in the basic and dilutive per share computation.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Weighted average common shares issued	4,012,159	4,009,070	4,011,499	4,008,094
Average treasury stock shares	(179,028)	(153,722)	(179,028)	(142,777)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	3,833,131	3,855,348	3,832,471	3,865,317
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	174	110	84	146
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	3,833,305	3,855,458	3,832,555	3,865,463

Options to purchase 990 shares of common stock at a strike price of \$31.82 and 990 shares at a strike price of \$24.72 were outstanding during the three and nine months ended September 30, 2009. The average market price of the company's stock was \$32.62 and \$28.41 for the three and nine months ended September 30, 2009. Options to purchase 8,273 and 9,593 shares of common stock were outstanding during the three and nine months ended September 30, 2008 but were not included in the computation of diluted earnings per share as they were anti-dilutive due to the strike price being greater than the average market price for the three and nine months ended September 30, 2008.

Table of Contents**Note 4. Net Periodic Benefit Cost-Defined Benefit Plans**

For a 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 Annual Report on Form 10-K for the year ended December 31, 2008.

The following sets forth the components of the net periodic benefit cost of the domestic non-contributory defined benefit plan for the three and nine months ended September 30, 2009 and 2008, respectively:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Service cost	\$ 136	\$ 137	\$ 408	\$ 410
Interest cost	170	152	510	456
Expected return on plan assets	(127)	(161)	(381)	(481)
Amortization of transition obligation	(1)	(1)	(2)	(2)
Amortization of prior service cost	6	6	19	19
Amortization of net loss	85	14	254	42
Net periodic cost	\$ 269	\$ 147	\$ 808	\$ 444

Employer Contributions

The Company previously disclosed in its consolidated financial statements, included in the Annual Report on Form 10-K for the year ended December 31, 2008, that it expected to contribute a minimum of \$325,000 to its defined benefit plan in 2009. As of September 30, 2009, there were contributions of \$662,000 made to the plan. The Company expects to contribute a minimum of \$143,000 to the defined benefit plan during the remaining period of 2009.

Note 5. Off Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are primarily comprised of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit, interest rate, or liquidity risk in excess of the amount recognized in the consolidated balance sheet. The contract amounts of these instruments express the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss from nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company may require collateral or other security to support financial instruments with off-balance sheet credit risk.

Table of Contents

Financial instruments whose contract amounts represent credit risk are as follows at September 30, 2009 and December 31, 2008:

(In Thousands)	September 30, 2009		December 31, 2008	
Commitments to extend credit	\$	82,526	\$	85,871
Standby letters of credit		1,524		841

Commitments to extend credit are legally binding agreements to lend to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future liquidity requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, on an extension of credit is based on management's credit assessment of the counterparty.

Standby letters of credit represent conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These instruments are issued primarily to support bid or performance related contracts. The coverage period for these instruments is typically a one year period with an annual renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized upon expiration of the coverage period. For secured letters of credit, the collateral is typically Bank deposit instruments or customer business assets.

Note 6. Reclassification of Comparative Amounts

Certain comparative amounts for the prior period have been reclassified to conform to current period presentations. Such reclassifications had no effect on net income or shareholders' equity.

Note 7. Employee Stock Purchase Plan

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The Company maintains the Penns Woods Bancorp, Inc. 2006 Employee Stock Purchase Plan (Plan). The Plan is intended to encourage employee participation in the ownership and economic progress of the Company. The Plan allows for up to 1,000,000 shares to be purchased by employees. The purchase price of the shares is 95% of market value with an employee eligible to purchase up to the lesser of 15% of base compensation or \$12,000 in market value annually. During the nine months ended September 30, 2009 and 2008, there were 1,991 and 2,282 shares issued under the plan, respectively.

Note 8. Fair Value Measurements

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The Company adopted FASB ASC Topic 820 Fair Value Measurements and Disclosures effective January 1, 2008, which provides a framework for measuring fair value under GAAP.

Table of Contents

FASB ASC Topic 820 Fair Value Measurements and Disclosures defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
- Level II: Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.
- Level III: Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following table presents the assets reported on the balance sheet at their fair value on a recurring basis as of September 30, 2009 and December 31, 2008, by level within the fair value hierarchy. As required by GAAP, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

(In Thousands)	September 30, 2009			Total
	Level I	Level II	Level III	
Assets Measured on a Recurring Basis:				
Investment Securities, available-for-sale	\$ 12,075	\$ 207,329	\$	\$ 219,404
(In Thousands)	December 31, 2008			Total
	Level I	Level II	Level III	
Assets Measured on a Recurring Basis:				
Investment Securities, available-for-sale	\$ 13,269	\$ 194,982	\$	\$ 208,251

The following table presents the assets reported on the balance sheet at their fair value on a non-recurring basis as of September 30, 2009 and December 31, 2008, by level within the fair value hierarchy. As required by GAAP, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Table of Contents

(In Thousands)	September 30, 2009			Total
	Level I	Level II	Level III	
Assets Measured on a Non-recurring Basis:				
Impaired Loans	\$	\$ 6,802	\$	\$ 6,802
(In Thousands)	December 31, 2008			Total
	Level I	Level II	Level III	
Assets Measured on a Non-recurring Basis:				
Impaired Loans	\$	\$ 4,876	\$	\$ 4,876

Note 9. Estimated Fair Value Of Financial Instruments

The Company is required to disclose estimated fair values for its financial instruments. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Also, it is the Company's general practice and intention to hold most of its financial instruments to maturity and not to engage in trading or sales activities. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions can significantly affect the estimates.

Estimated fair values have been determined by the Company using historical data and an estimation methodology suitable for each category of financial instruments. The Company's fair value estimates, methods, and assumptions are set forth below for the Company's other financial instruments.

As certain assets and liabilities, such as deferred tax assets, premises and equipment, and many other operational elements of the Company, are not considered financial instruments but have value, this estimated fair value of financial instruments would not represent the full market value of the Company.

The estimated fair values of the Company's financial instruments are as follows at September 30, 2009 and December 31, 2008:

Table of Contents

(In Thousands)	September 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 12,663	\$ 12,663	\$ 16,581	\$ 16,581
Investment securities:				
Available for sale	219,404	219,404	208,251	208,251
Held to maturity	110	111	135	136
Loans held for sale	5,403	5,403	3,622	3,622
Loans, net	396,347	403,527	377,122	380,771
Bank-owned life insurance	15,023	15,023	14,546	14,546
Accrued interest receivable	3,515	3,515	3,614	3,614
Financial liabilities:				
Interest-bearing deposits	\$ 414,493	\$ 417,427	\$ 345,333	\$ 347,657
Noninterest-bearing deposits	75,569	75,569	76,035	76,035
Short-term borrowings	21,440	21,440	73,946	73,946
Long-term borrowings, FHLB	86,778	89,932	86,778	88,188
Accrued interest payable	1,191	1,191	1,317	1,317

Table of Contents

Cash and Cash Equivalents, Loans Held for Sale, Accrued Interest Receivable, Short-term Borrowings, and Accrued Interest Payable:

The fair value is equal to the carrying value.

Investment Securities:

The fair value of investment securities available for sale and held to maturity is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Regulatory stocks fair value is equal to the carrying value.

Loans:

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial real estate, residential real estate, construction real estate, and other consumer. Each loan category is further segmented into fixed and adjustable rate interest terms and by performing and nonperforming categories.

The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions.

Fair value for significant nonperforming loans is based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discounted rates are judgmentally determined using available market information and specific borrower information.

Bank-Owned Life Insurance:

The fair value is equal to the cash surrender value of the life insurance policies.

Deposits:

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW, and money market accounts, is equal to the amount payable on demand as of September 30, 2009 and December 31, 2008. The fair value of certificates of deposit is based on the discounted value of contractual cash flows.

The fair value estimates above do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market, commonly referred to as the core deposit intangible.

Long Term Borrowings:

The fair value of long term borrowings is based on the discounted value of contractual cash flows.

Table of Contents

Commitments to Extend Credit, Standby Letters of Credit, and Financial Guarantees Written:

There is no material difference between the notional amount and the estimated fair value of off-balance sheet items at September 30, 2009 and December 31, 2008. The contractual amounts of unfunded commitments and letters of credit are presented in Note 5.

Note 10. Federal Home Loan Bank Stock

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The Bank is a member of the Federal Home Loan Bank of Pittsburgh (the FHLB), which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the Federal Home Loan Bank. As a member, the Bank is required to purchase and maintain stock in the FHLB in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of its outstanding advances from the FHLB. At September 30, 2009, the Bank held \$7,271,300 in stock of the FHLB, which was in compliance with this requirement.

The Company evaluated its holding of FHLB stock for impairment and deemed the stock to not be impaired due to the expected recoverability of the par value, which equals the value reflected within the Company's financial statements. The decision was based on several items ranging from the estimated true economic losses embedded within the FHLB's mortgage portfolio to the FHLB's liquidity position and credit rating. The Company utilizes the impairment framework outlined in GAAP to evaluate FHLB stock for impairment.

The following factors were evaluated to determine the ultimate recoverability of the par value of the Company's FHLB stock holding; (i) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted; (ii) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (iii) the impact of legislative and regulatory changes on the institutions and, accordingly, on the customer base of the FHLB; (iv) the liquidity position of the FHLB; and (v) whether a decline is temporary or whether it affects the ultimate recoverability of the FHLB stock based on (a) the materiality of the carrying amount to the member institution and (b) whether an assessment of the institution's operational needs for the foreseeable future allow management to dispose of the stock.

Based on its analysis of these factors, the Company determined that its holding of FHLB stock was not impaired on September 30, 2009.

Note 11. Investment Securities

The amortized cost and estimated fair values of investment securities at September 30, 2009 and December 31, 2008 are as follows:

Table of Contents

(In Thousands)

	September 30, 2009				Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		
Available for sale (AFS)					
U.S. Government and agency securities	\$ 38,518	\$ 2,099		\$	\$ 40,617
State and political securities	144,464	4,351		(4,160)	144,655
Other debt securities	21,111	1,287		(341)	22,057
Total debt securities	204,093	7,737		(4,501)	207,329
Equity securities	11,266	1,005		(196)	12,075
Total investment securities AFS	\$ 215,359	\$ 8,742		\$ (4,697)	\$ 219,404
Held to maturity (HTM)					
U.S. Government and agency securities	\$ 9	\$ 1		\$	\$ 10
Other debt securities	101				101
Total investment securities HTM	\$ 110	\$ 1		\$	\$ 111

(In Thousands)

	December 31, 2008				Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		
Available for sale (AFS)					
U.S. Government and agency securities	\$ 46,452	\$ 1,134		\$	\$ 47,586
State and political securities	142,258	348		(10,764)	131,842
Other debt securities	15,970	649		(1,065)	15,554
Total debt securities	204,680	2,131		(11,829)	194,982
Equity securities	16,429	225		(3,385)	13,269
Total investment securities AFS	\$ 221,109	\$ 2,356		\$ (15,214)	\$ 208,251
Held to maturity (HTM)					
U.S. Government and agency securities	\$ 10	\$ 1		\$	\$ 11
Other debt securities	125				125
Total investment securities HTM	\$ 135	\$ 1		\$	\$ 136

Table of Contents

The following tables show the Company's gross unrealized losses and estimated fair value, aggregated by investment category and length of time, that the individual securities have been in a continuous unrealized loss position, at September 30, 2009 and December 31, 2008.

(In Thousands)

	Less than Twelve Months		September 30, 2009 Twelve Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
U.S. Government and agency securities	\$	\$	\$	\$	\$	\$
State and political securities	700	35	38,818	4,125	39,518	4,160
Other debt securities			3,968	341	3,968	341
Total debt securities	700	35	42,786	4,466	43,486	4,501
Equity securities	743	122	500	74	1,243	196
Total	\$ 1,443	\$ 157	\$ 43,286	\$ 4,540	\$ 44,729	\$ 4,697

(In Thousands)

	Less than Twelve Months		December 31, 2008 Twelve Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
U.S. Government and agency securities	\$	\$	\$	\$	\$	\$
State and political securities	48,388	4,378	67,412	6,386	115,800	10,764
Other debt securities	6,341	451	2,012	614	8,353	1,065
Total debt securities	54,729	4,829	69,424	7,000	124,153	11,829
Equity securities	164	80	5,364	3,305	5,528	3,385
Total	\$ 54,893	\$ 4,909	\$ 74,788	\$ 10,305	\$ 129,681	\$ 15,214

Table of Contents

At September 30, 2009 there were a total of 10 and 115 individual securities that were in a continuous unrealized loss position for less than twelve months and greater than twelve months, respectively.

The Company reviews its position quarterly and has asserted that at September 30, 2009, the declines outlined in the above table represent temporary declines and the Company does have the intent and ability either to hold those securities to maturity or to allow a market recovery. There were 125 positions that were temporarily impaired at September 30, 2009. The Company has concluded that the unrealized losses disclosed above are not other than temporary but are the result of interest rate changes, sector credit ratings changes, or company-specific ratings changes that are not expected to result in the non-collection of principal and interest during the period.

The amortized cost and estimated fair value of debt securities at September 30, 2009, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities since borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(In Thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 25	\$ 25	\$ 25	\$ 25
Due after one year to five years	11,228	12,001	76	76
Due after five years to ten years	1,142	1,165		
Due after ten years	191,698	194,138	9	10
Total	\$ 204,093	\$ 207,329	\$ 110	\$ 111

Total gross proceeds from sales of securities available for sale were \$5,377,000 and \$39,994,000, for September 30, 2009 and 2008, respectively. The following table represents gross realized gains and losses on those transactions:

(In Thousands)	September 30, 2009	September 30, 2008
Gross realized gains:		
U.S. Government and agency securities	\$	\$ 253
State and political securities		235
Other debt securities	180	
Equity securities	21	486
Total gross realized gains	\$ 201	\$ 974
Gross realized losses:		
U.S. Government and agency securities	\$	\$ 36
State and political securities		204
Other debt securities	165	232
Equity securities	4,998	2,219
Total gross realized losses	\$ 5,163	\$ 2,691

Gross realized losses for the equity securities portfolio include impairment charges of \$4,614,000 and \$2,425,000 for the nine months ended September 30, 2009 and 2008, respectively.

Table of Contents**Note 12. Loans**

The allocation of the loan portfolio, by delinquency status, as of September 30, 2009 and December 31, 2008 is presented below:

(In Thousands)

	September 30, 2009					Total
	Current	Past Due 30 To 90 Days	Past Due 90 Days Or More & Still Accruing	Non- Accrual		
Commercial and agricultural	\$ 46,801	\$ 412	\$ 1	\$ 1	\$ 1	\$ 47,214
Real estate mortgage:						
Residential	170,233	2,790	1,209	502		174,734
Commercial	143,893	4,779	245	341		149,258
Construction	15,400	27	2,898	556		18,881
Installment loans to individuals	11,435	200	44	48		11,727
	387,762	\$ 8,208	\$ 4,396	\$ 1,448		401,814
Less:						
Net deferred loan fees	989					989
Allowance for loan losses	4,478					4,478
Loans, net	\$ 382,295					\$ 396,347

(In Thousands)

	December 31, 2008					Total
	Past Due 30 To 90 Current	Past Due 90 Days Or More & Still Days	Non- Accruing	Accrual		
Commercial and agricultural	\$ 40,006	\$ 517	\$ 79	\$ 79	\$ 79	\$ 40,602
Real estate mortgage:						
Residential	170,011	6,582	223	590		177,406
Commercial	134,647	775		736		136,158
Construction	15,652	167		19		15,838
Installment loans to individuals	12,053	346	36	52		12,487
	372,369	\$ 8,387	\$ 259	\$ 1,476		382,491
Less:						
Net deferred loan fees	1,013					1,013
Allowance for loan losses	4,356					4,356
Loans, net	\$ 367,000					\$ 377,122

The recorded investment in loans for which impairment has been recognized amounted to \$6,802,000 at September 30, 2009, compared to \$5,042,000 at December 31, 2008. The valuation allowance related to impaired loans amounted to \$536,000 at September 30, 2009 and \$166,000 at December 31, 2008. The increase in impaired loans and valuation allowance is primarily from a few commercial relationships.

A loan is considered impaired, based on current information and events, if it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral.

Table of Contents

Note 13. Subsequent Events

The Company assessed events occurring subsequent to September 30, 2009 through November 9, 2009 for potential recognition and disclosure in the consolidated financial statements. No events have occurred that would require adjustment to or disclosure in the consolidated financial statements which were issued on November 9, 2009.

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

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

You should not put undue reliance on any forward-looking statements. These statements speak only as of the date of this Quarterly Report on Form 10-Q, even if subsequently made available by the Company on its website or otherwise. The Company undertakes no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

EARNINGS SUMMARY

Comparison of the Three and Nine Months Ended September 30, 2009 and 2008

Summary Results

Net income for the three months ended September 30, 2009 was \$1,922,000 compared to \$1,552,000 for the same period of 2008 as after-tax securities losses decreased \$658,000 (from a loss of \$993,000 to a loss of \$335,000). Included within the change in after-tax securities losses was an other than temporary impairment charge relating to certain equity securities held in the investment portfolio of \$30,000. Basic and diluted earnings per share for the three months ended September 30, 2009 were \$0.50 compared to \$0.40 for the three months ended September 30, 2008. Return on average assets and return on average equity were 1.15% and 12.08% for the three months ended September 30, 2009 compared to 0.98% and 9.43% for the corresponding period of 2008. Net income from core operations (operating earnings) decreased to \$2,257,000 for the three months ended September 30, 2009 compared to \$2,545,000 for the same period of 2008. Operating earnings per share for the three months ended September 30, 2009 were \$0.59 basic and dilutive compared to \$0.66 basic and dilutive for the three months ended September 30, 2008.

The nine months ended September 30, 2009 generated net income of \$3,593,000 compared to \$5,740,000 for the same period of 2008. Comparable results were impacted by an increase in after-tax securities losses of \$2,142,000 (from a loss of \$1,133,000 to a loss of \$3,275,000). Earnings per share, basic and diluted, for the nine months ended September 30, 2009 were \$0.94 as compared to \$1.49 for the comparable period of 2008. Return on average assets and return on average equity were 0.73% and 7.80% for the nine months ended September 30, 2009 compared to 1.21% and 11.10% for the corresponding period of 2008. Operating earnings remained stable at \$6,868,000 for the nine months ended September 30, 2009 compared to \$6,873,000 for the comparable period of 2008, resulting in basic and dilutive operating earnings per share increasing to \$1.79 from \$1.78 for the nine month periods ended September 30, 2009 and 2008, respectively.

Management uses the non-GAAP measure of net income from core operations, or operating earnings, in its analysis of the Company's performance. This measure, as used by the Company, adjusts net income by excluding significant gains or losses that are unusual in nature. Because certain of these items and their impact on the Company's performance are difficult to predict, management believes the presentation of financial measures excluding the impact of such items provides useful supplemental information in evaluating the operating results of the Company's core businesses. For purposes of this Quarterly Report on Form 10-Q, net income from core operations, or operating earnings, means net income adjusted to exclude after-tax net securities gains or losses. These disclosures should not be viewed as a substitute for net income determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.

Table of Contents**Reconciliation of GAAP and non-GAAP Income**

(In Thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009	2008	2009	2008	2009	2008	2009	2008
GAAP net income	\$	1,922	\$	1,552	\$	3,593	\$	5,740
Securities losses, net of tax		(335)		(993)		(3,275)		(1,133)
Non-GAAP operating earnings	\$	2,257	\$	2,545	\$	6,868	\$	6,873

Interest and Dividend Income

Interest and dividend income for the three months ended September 30, 2009 remained stable at \$9,113,000 compared to \$9,108,000 for the same period of 2008. The increase in interest income was the result of an increase in loan interest of \$146,000 which offset the decline in investment securities income of \$141,000. The increase in loan interest is the result of growth in the average gross loan portfolio of \$25,843,000. The growth offset a decline in the average taxable equivalent yield of 27 basis points (bp) caused by the low interest rate environment that has existed over the past year. Dividend income decreased as a direct result of the current status of the economy that has caused many of the issuers of equity holdings in our portfolio to decrease or suspend their dividend. In addition, the Federal Home Loan Bank of Pittsburgh (FHLB) has suspended payment of dividends on shares of its common stock, which resulted in a decrease of approximately \$81,000 in dividend income for the third quarter of 2009 compared to 2008. On a taxable equivalent basis, total interest income increased \$74,000 due to volume increases that offset the decline in yield.

During the nine months ended September 30, 2009, interest and dividend income was \$27,043,000, a decrease of \$49,000 over the same period in 2008. Interest income on the loan portfolio increased \$89,000 as the growth in the portfolio countered a 38 bp decline in average yield. The investment portfolio interest income was negatively impacted by approximately \$240,000 due to the suspension of FHLB dividends which resulted in total interest income from investment securities decreasing \$138,000 from the comparable period of 2008. Tax-equivalent interest income increased \$144,000 due to an overall increase in earning assets of \$21,368,000, and a shift in the earning asset portfolio towards loans from investments.

Interest and dividend income composition for the three and nine months ended September 30, 2009 and 2008 was as follows:

Table of Contents

	September 30, 2009		For The Three Months Ended September 30, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
Loans including fees	\$ 6,457	70.9%	\$ 6,311	69.3%	\$ 146	2.3%
Investment securities:						
Taxable	1,368	15.0	1,391	15.3	(23)	(1.7)
Tax-exempt	1,253	13.7	1,205	13.2	48	4.0
Dividend and other interest income	35	0.4	201	2.2	(166)	(82.6)
Total interest and dividend income	\$ 9,113	100.0%	\$ 9,108	100.0%	\$ 5	0.1%

	September 30, 2009		For The Nine Months Ended September 30, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
Loans including fees	\$ 19,025	70.4%	\$ 18,936	69.9%	\$ 89	0.5%
Investment securities:						
Taxable	4,105	15.2	3,857	14.2	248	6.4
Tax-exempt	3,748	13.9	3,641	13.5	107	2.9
Dividend and other interest income	165	0.5	658	2.4	(493)	(74.9)
Total interest and dividend income	\$ 27,043	100.0%	\$ 27,092	100.0%	\$ (49)	(0.2)%

Interest Expense

Interest expense for the three months ended September 30, 2009 decreased \$427,000 to \$3,168,000 compared to \$3,595,000 for the same period of 2008. The decreased expense of \$262,000 associated with deposits is primarily the result of a reduction of 86 bp in rates paid on time deposits. Factors that led to the rate decreases include, but are not limited to, Federal Open Market Committee (FOMC) interest rate actions and campaigns conducted by the Company during the past two years to attract short-term CDs resulting in an increased repricing frequency. Short-term borrowings interest expense decreased \$228,000 as the average balance of such borrowings decreased \$35,758,000, while the rate paid declined 25 bp. Long-term borrowing interest expense increased \$63,000 as the average balance of such borrowings increased slightly, while the average rate decreased 10 bp to 4.23%.

Interest expense for the nine months ended September 30, 2009 decreased \$2,086,000 from the same period of 2008. The reasons noted for the decline in interest expense for the three month period comparison also apply to the nine month period.

Interest expense composition for the three and nine months ended September 30, 2009 and 2008 was as follows:

Table of Contents

(In Thousands)	September 30, 2009		For The Three Months Ended September 30, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
	Deposits	\$ 2,148	67.8%	\$ 2,410	67.0%	\$ (262)
Short-term borrowings	82	2.6	310	8.6	(228)	(73.5)
Long-term borrowings, FHLB	938	29.6	875	24.4	63	7.2
Total interest expense	\$ 3,168	100.0%	\$ 3,595	100.0%	\$ (427)	(11.9)%

(In Thousands)	September 30, 2009		For The Nine Months Ended September 30, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
	Deposits	\$ 6,357	67.2%	\$ 7,502	65.0%	\$ (1,145)
Short-term borrowings	318	3.4	996	8.6	(678)	(68.1)
Long-term borrowings, FHLB	2,781	29.4	3,044	26.4	(263)	(8.6)
Total interest expense	\$ 9,456	100.0%	\$ 11,542	100.0%	\$ (2,086)	(18.1)%

Net Interest Margin

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The net interest margin (NIM) for the three months ended September 30, 2009 was 4.35% compared to 4.23% for the corresponding period of 2008. The increase in the NIM was driven by a 52 bp decline in the rate paid on interest bearing liabilities that more than compensated for a 27 bp decline in the yield on earning assets. The decrease in earning asset yield is due to the impact on the loan and investment portfolios of the current low rate environment. The decrease in the cost of interest bearing liabilities to 2.41% from 2.93% was driven by a reduction in the rate paid on time deposits of 86 bp. The reduction in the rate paid on time deposits was the result of a shortening of the time deposit portfolio that has resulted in an increasing repricing frequency during this period of decreasing rates. The duration of the time deposit portfolio began to be lengthened during the second and through the third quarter of 2009 due to the apparent bottoming or near bottoming of deposit rates.

The NIM for the nine months ended September 30, 2009 was 4.39% compared to 4.04% for the same period of 2008. The impact of the items mentioned in the three month discussion also applies to the nine month period. A 113 bp decline in the rate paid on time deposits served as the foundation for an 78 bp decline in rate paid on deposits, while the FOMC and general market actions affected the yield on earning assets and cost of borrowings.

The following is a schedule of average balances and associated yields for the three and nine months ended September 30, 2009 and 2008:

Table of Contents

	AVERAGE BALANCES AND INTEREST RATES					
	Three Months Ended September 30, 2009			Three Months Ended September 30, 2008		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets:						
Tax-exempt loans	\$ 17,207	\$ 279	6.43%	\$ 9,108	\$ 148	6.46%
All other loans	382,670	6,273	6.50%	364,926	6,213	6.77%
Total loans	399,877	6,552	6.50%	374,034	6,361	6.77%
Taxable investment securities	104,905	1,402	5.35%	107,751	1,592	5.91%
Tax-exempt investment securities	104,719	1,898	7.25%	103,431	1,826	7.06%
Total securities	209,624	3,300	6.30%	211,182	3,418	6.47%
Interest bearing deposits	4,218	1	0.09%	34		0.00%
Total interest-earning assets	613,719	9,853	6.39%	585,250	9,779	6.66%
Other assets	54,284			50,225		
Total assets	\$ 668,003			\$ 635,475		
Liabilities and shareholders equity:						
Savings	\$ 62,265	85	0.54%	\$ 62,792	120	0.76%
Super Now deposits	60,476	127	0.83%	52,970	175	1.31%
Money market deposits	71,204	345	1.92%	34,915	208	2.37%
Time deposits	222,816	1,591	2.83%	205,346	1,907	3.69%
Total deposits	416,761	2,148	2.04%	356,023	2,410	2.69%
Short-term borrowings	15,457	82	2.13%	51,215	310	2.38%
Long-term borrowings, FHLB	86,778	938	4.23%	79,061	875	4.33%
Total borrowings	102,235	1,020	3.91%	130,276	1,185	3.57%
Total interest-bearing liabilities	518,996	3,168	2.41%	486,299	3,595	2.93%
Demand deposits	75,114			75,863		
Other liabilities	10,256			7,467		
Shareholders equity	63,637			65,846		
Total liabilities and shareholders equity	\$ 668,003			\$ 635,475		
Interest rate spread			3.97%			3.73%
Net interest income/margin		\$ 6,685	4.35%		\$ 6,184	4.23%

1. Information on this table has been calculated using average daily balance sheets to obtain average balances.

2. Nonaccrual loans have been included with loans for the purpose of analyzing net interest earnings.

3. Income and rates on a fully taxable equivalent basis include an adjustment for the difference between annual income from tax-exempt obligations and the taxable equivalent of such income at the standard 34% tax rate.

Table of Contents

	AVERAGE BALANCES AND INTEREST RATES					
	Nine Months Ended September 30, 2009			Nine Months Ended September 30, 2008		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets:						
Tax-exempt loans	\$ 16,682	\$ 817	6.55%	\$ 8,534	\$ 411	6.43%
All other loans	378,043	18,486	6.54%	359,570	18,665	6.93%
Total loans	394,725	19,303	6.54%	368,104	19,076	6.92%
Taxable securities	102,937	4,269	5.53%	104,604	4,514	5.75%
Tax-exempt securities	103,418	5,679	7.32%	108,877	5,517	6.76%
Total securities	206,355	9,948	6.43%	213,481	10,031	6.27%
Interest bearing deposits	1,886	1	0.07%	13	1	10.28%
Total interest-earning assets	602,966	29,252	6.48%	581,598	29,108	6.68%
Other assets	55,080			49,638		
Total assets	\$ 658,046			\$ 631,236		
Liabilities and shareholders equity:						
Savings	\$ 61,106	244	0.53%	\$ 60,857	343	0.75%
Super Now deposits	57,028	387	0.91%	51,228	513	1.34%
Money market deposits	59,061	924	2.09%	28,372	481	2.26%
Time deposits	217,679	4,802	2.95%	201,950	6,165	4.08%
Total Deposits	394,874	6,357	2.15%	342,407	7,502	2.93%
Short-term borrowings	31,491	318	1.39%	47,894	996	2.75%
Other borrowings	86,778	2,781	4.23%	90,088	3,044	4.44%
Total borrowings	118,269	3,099	3.47%	137,982	4,040	3.85%
Total interest-bearing liabilities	513,143	9,456	2.46%	480,389	11,542	3.19%
Demand deposits	73,469			73,205		
Other liabilities	10,018			8,672		
Shareholders equity	61,416			68,970		
Total liabilities and shareholders equity	\$ 658,046			\$ 631,236		
Interest rate spread			4.02%			3.49%
Net interest income/margin		\$ 19,796	4.39%		\$ 17,566	4.04%

- Information on this table has been calculated using average daily balance sheets to obtain average balances.
- Nonaccrual loans have been included with loans for the purpose of analyzing net interest earnings.

3. Income and rates on a fully taxable equivalent basis include an adjustment for the difference between annual income from tax-exempt obligations and the taxable equivalent of such income at the standard 34% tax rate.

Table of Contents

The following table presents the adjustment to convert net interest income to net interest income on a fully taxable equivalent basis for the three and nine months ended September 30, 2009 and 2008.

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

(In Thousands)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
Total interest income	\$ 9,113	\$ 9,108	\$ 27,043	\$ 27,092
Total interest expense	3,168	3,595	9,456	11,542
Net interest income	5,945	5,513	17,587	15,550
Tax equivalent adjustment	740	671	2,209	2,016
Net interest income (fully taxable equivalent)	\$ 6,685	\$ 6,184	\$ 19,796	\$ 17,566

The following table sets forth the respective impact that both volume and rate changes have had on net interest income on a fully taxable equivalent basis for the three and nine month periods ended September 30, 2009 and 2008:

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

(In Thousands)	Three Months Ended September 30, 2009 vs 2008			Nine Months Ended September 30, 2009 vs 2008		
	Increase (Decrease)			Increase (Decrease)		
	Volume	Due to Rate	Net	Volume	Due to Rate	Net
Interest income:						
Loans, tax-exempt	\$ 132	\$ (1)	\$ 131	\$ 398	\$ 8	\$ 406
Loans	306	(246)	60	916	(1,095)	(179)
Taxable investment securities	(40)	(150)	(190)	(71)	(174)	(245)
Tax-exempt investment securities	22	50	72	(268)	430	162
Interest bearing deposits	1		1	144	(144)	
Total interest-earning assets	421	(347)	74	1,119	(975)	144
Interest expense:						
Savings deposits	(1)	(34)	(35)	1	(100)	(99)
Super Now deposits	22	(70)	(48)	53	(179)	(126)
Money market deposits	182	(45)	137	483	(40)	443
Time deposits	152	(468)	(316)	450	(1,813)	(1,363)
Short-term borrowings	(193)	(35)	(228)	(9)	(669)	(678)
Long-term borrowings, FHLB	83	(20)	63	(106)	(157)	(263)
Total interest-bearing liabilities	245	(672)	(427)	872	(2,958)	(2,086)
Change in net interest income	\$ 176	\$ 325	\$ 501	\$ 247	\$ 1,983	\$ 2,230

Provision for Loan Losses

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also

Table of Contents

performed annually for the Bank. Management remains committed to an aggressive program of problem loan identification and resolution.

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

Although management believes it uses the best information available to make such determinations and that the allowance for loan losses is adequate at September 30, 2009, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy, increased unemployment, and delays in receiving financial information from borrowers could result in increased levels of nonperforming assets, charge-offs, loan loss provisions, and reductions in income. Additionally, as an integral part of the examination process, bank regulatory agencies periodically review the Bank's loan loss allowance. The banking agencies could require the recognition of additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

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

The allowance for loan losses increased from \$4,356,000 at December 31, 2008 to \$4,478,000 at September 30, 2009. At September 30, 2009 and December 31, 2008, the allowance for loan losses to total loans was 1.12% and 1.14%, respectively.

The provision for loan losses totaled \$270,000 and \$582,000 for the three and nine months ended September 30, 2009, compared to \$110,000 and \$230,000 for the same period in 2008. The amount of the increase in the provision was the result of several factors, including but not limited to, an increase in gross loans of \$19,347,000 since December 31, 2008, a ratio of net charge offs to average loans of 0.12% for the nine months ended September 30, 2009, a ratio of nonperforming loans to total loans of 1.46%, and a ratio of the allowance for loan losses to nonperforming loans of 76.63% at September 30, 2009. As noted in the following schedules, there has been an increase in nonperforming loans and net charge-offs over the past year. Nonperforming loans increased to \$5,844,000 at September 30, 2009 from \$1,735,000 at December 31, 2008 due primarily to a commercial real estate loan of approximately \$2,800,000 being classified as 90 days past due as of September 30, 2009. The loan is collateralized with no loss anticipated at this time. Continued uncertainty surrounding the economy and internal loan review and analysis, coupled with the ratios noted previously, dictated an increase in the provision for loan losses. The increase did not equate to the increase in charge-offs and nonperforming loans due to the collateral status of the nonperforming loans and overall loan portfolio in general, which limits the loan specific allocation of the allowance for loan losses.

Table of Contents

Following is a table showing the changes in the allowance for loan losses for the nine month periods ended September 30, 2009 and 2008:

(In Thousands)	2009		2008	
Balance at beginning of period	\$	4,356	\$	4,130
Charge-offs:				
Real estate		272		29
Commercial and industrial		129		31
Installment loans to individuals		142		174
Total charge-offs		543		234
Recoveries:				
Real estate		11		13
Commercial and industrial		2		60
Installment loans to individuals		70		69
Total recoveries		83		142
Net charge-offs		460		92
Additions charged to operations		582		230
Balance at end of period	\$	4,478	\$	4,268
Ratio of net charge-offs during the period to average loans outstanding during the period		0.12%		0.02%

Following is a table showing the changes in total nonperforming loans as of:

(In Thousands)	Total Nonperforming Loans			Total
	Nonaccrual	90 Days Past Due		
09/30/09	\$ 1,448	\$ 4,396		5,844
06/30/09	2,089	578		2,667
03/31/09	2,033	236		2,269
12/31/08	1,476	259		1,735
09/30/08	818	123		941

Loans not included above which are troubled debt restructurings as defined in FAS 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, totaled \$275,000, \$31,000, and \$353,000 at September 30, 2008, December 31, 2008, and September 30, 2009, respectively.

Non-interest Income

Total non-interest income for the three months ended September 30, 2009 compared to the same period in 2008 increased \$909,000 to \$1,381,000 due to a \$997,000 decrease in net securities losses. Excluding net securities gains and losses, non-interest income for the third quarter of

Table of Contents

2009 would have decreased \$88,000 compared to the 2008 period. Deposit service charges decreased \$41,000 as overdraft fee income decreased \$29,000, in addition to customers migrating to no service charge checking accounts that were introduced as part of a customer acquisition and retention program. Gain on sale of loans decreased \$9,000 due primarily from a change in product mix which has resulted in a greater percentage of the fee collected being categorized as other income. This shift in product mix resulted in other income increasing 12.8% or \$68,000.

Insurance commissions for the three months ended September 30, 2009 decreased \$129,000 compared to the same period in 2008 due to a softening market and shift in product mix. Management of The M Group continues to pursue new and build upon current relationships. The sales call program continues to expand to other financial institutions, which results in additional revenue for The M Group if another sales outlet is added. However, the addition of another sales outlet for The M Group can take up to a year or more to be completed.

Total non-interest income for the nine months ended September 30, 2009 compared to the same period in 2008 decreased \$3,794,000. Excluding net securities gains, non-interest income would have decreased \$549,000 compared to the 2008 period. The decrease in non-interest income for the nine month period is the result of the same items noted in the three month discussion.

Non-interest income composition for the three and nine months ended September 30, 2009 and 2008 was as follows:

	(In Thousands)		For The Three Months Ended		Change	
	September 30, 2009		September 30, 2008			
	Amount	% Total	Amount	% Total	Amount	%
Deposit service charges	\$ 553	40.0%	\$ 594	125.8%	\$ (41)	(6.9)%
Securities losses, net	(507)	(36.7)	(1,504)	(318.6)	997	(66.3)
Bank owned life insurance	144	10.4	121	25.6	23	19.0
Gain on sale of loans	305	22.1	314	66.5	(9)	(2.9)
Insurance commissions	287	20.8	416	88.1	(129)	(31.0)
Other	599	43.4	531	112.6	68	12.8
Total non-interest income	\$ 1,381	100.0%	\$ 472	100.0%	\$ 909	192.6%

	(In Thousands)		For The Nine Months Ended		Change	
	September 30, 2009		September 30, 2008			
	Amount	% Total	Amount	% Total	Amount	%
Deposit service charges	\$ 1,619	760.1%	\$ 1,704	42.5%	\$ (85)	(5.0)%
Securities losses, net	(4,962)	(2,329.5)	(1,717)	(42.9)	(3,245)	189.0
Bank owned life insurance	418	196.2	367	9.2	51	13.9
Gain on sale of loans	526	246.9	678	16.9	(152)	(22.4)
Insurance commissions	988	463.8	1,482	37.0	(494)	(33.3)
Other	1,624	762.5	1,493	37.3	131	8.8
Total non-interest income	\$ 213	100.0%	\$ 4,007	100.0%	\$ (3,794)	(94.7)%

Table of Contents**Non-interest Expense**

Total non-interest expense increased \$646,000 for the three months ended September 30, 2009 compared to the same period of 2008. The \$233,000 increase in salaries and employee benefits was attributable to several items including standard cost of living wage adjustments for employees, increased pension expense, and other benefit costs. Pennsylvania shares tax increased due to the utilization of Pennsylvania Enterprise Zone tax credits from a low income housing partnership during 2008. Other expenses increased primarily due to normal anticipated inflationary adjustments to ongoing business operating costs in addition to increased FDIC insurance cost.

Total non-interest expense increased \$1,220,000 for the nine months ended September 30, 2009 compared to the same period of 2008. The increase in non-interest expense for the nine month period is the result of the same items noted in the three month discussion.

Non-interest expense composition for the three and nine months ended September 30, 2009 and 2008 was as follows:

(In Thousands)	September 30, 2009		For The Three Months Ended September 30, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
Salaries and employee benefits	\$ 2,588	50.8%	\$ 2,355	52.9%	\$ 233	9.9%
Occupancy, net	299	5.9	315	7.1	(16)	(5.1)
Furniture and equipment	293	5.7	304	6.8	(11)	(3.6)
Pennsylvania shares tax	171	3.4	105	2.4	66	62.9
Amortization of investment in limited partnerships	142	2.8	178	4.0	(36)	(20.2)
Other	1,604	31.4	1,194	26.8	410	34.3
Total non-interest expense	\$ 5,097	100.0%	\$ 4,451	100.0%	\$ 646	14.5%

(In Thousands)	September 30, 2009		For The Nine Months Ended September 30, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
Salaries and employee benefits	\$ 7,665	52.4%	\$ 7,275	54.3%	\$ 390	5.4%
Occupancy, net	956	6.5	967	7.2	(11)	(1.1)
Furniture and equipment	906	6.2	876	6.5	30	3.4
Pennsylvania shares tax	514	3.5	315	2.3	199	63.2
Amortization of investment in limited partnerships	425	2.9	534	4.0	(109)	(20.4)
Other	4,161	28.5	3,440	25.7	721	21.0
Total non-interest expense	\$ 14,627	100.0%	\$ 13,407	100.0%	\$ 1,220	9.1%

Provision for Income Taxes

Income taxes increased \$165,000 and decreased \$1,182,000 for the three and nine months ended September 30, 2009 compared to the same periods of 2008. The primary cause of the changes in tax expense is the impact of net securities losses. Excluding the impact of the net securities gains and losses, the effective tax rate for the three and nine months ended September 30, 2009 was 8.48% and 9.07% as compared to 13.08% and 10.00% for the same periods of 2008. The Company currently is in a deferred tax asset position due to the low income housing tax credits earned both currently and previously. Management has reviewed the deferred tax asset and has determined that the asset will be utilized

within the appropriate carry forward period and therefore does not require a valuation allowance.

Table of Contents**ASSET/LIABILITY MANAGEMENT****Cash and Cash Equivalents**

Cash and cash equivalents decreased \$3,918,000 from \$16,581,000 at December 31, 2008 to \$12,663,000 at September 30, 2009 primarily as a result of the following activities during the nine months ended September 30, 2009:

Loans Held for Sale

Activity regarding loans held for sale resulted in loan originations exceeding sale proceeds, less \$526,000 in realized gains, by \$1,781,000 for the nine months ended September 30, 2009.

Loans

Gross loans increased \$19,347,000 since December 31, 2008 due to the increase of commercial related loans, while non-commercial loans remained relatively constant.

The allocation of the loan portfolio, by category, as of September 30, 2009 and December 31, 2008 is presented below:

(In Thousands)	September 30, 2009		December 31, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
Commercial, financial and agricultural	\$ 47,214	11.8%	\$ 40,602	10.6%	\$ 6,612	16.3%
Real estate mortgage:						
Residential	174,734	43.6	177,406	46.5	(2,672)	(1.5)
Commercial	149,258	37.2	136,158	35.7	13,100	9.6
Construction	18,881	4.7	15,838	4.2	3,043	19.2
Installment loans to individuals	11,727	2.9	12,487	3.3	(760)	(6.1)
Less: Net deferred loan fees	989	(0.2)	1,013	(0.3)	(24)	(2.4)
Gross loans	\$ 400,825	100.0%	\$ 381,478	100.0%	\$ 19,347	5.1%

Investments

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The estimated fair value of the investment securities portfolio at September 30, 2009 has increased \$11,128,000 since December 31, 2008. The change is primarily due to an increase in the estimated fair market value of the state and political securities segment of the portfolio. The amortized cost of this segment increased \$2,206,000 since December 31, 2008, however, the estimated fair market value increased \$12,813,000 over the same time period as the market for these securities has begun to rebound. The unrealized losses within the debt securities portfolio are the result of market activity, not credit issues/ratings, as approximately 90% of the debt securities portfolio is currently rated A or higher by either S&P or Moody's.

The Company considers various factors, which include examples from applicable accounting guidance, when analyzing the available for sale portfolio for possible other than temporary impairment. The Company primarily considers the following factors in its analysis: length of time and severity of the market value being less than carrying value, reduction of dividend paid

Table of Contents

(equities), continued payment of dividend/interest, credit rating, and financial condition of an issuer, intent and ability to hold until anticipated recovery (which may be maturity), and general outlook for the economy, specific industry, and entity in question.

The bond portion of the portfolio review is conducted with emphases on several factors. Continued payment of principal and interest is given primary importance with credit rating and financial condition of the issuer following as the next most important. Credit ratings were reviewed with the ratings of the bonds being satisfactory. Those that were not currently rated were discussed with a third party and/or underwent an internal financial review. The Company also monitors whether each of the investments incurred a decline in market value from carrying value of at least 20% for twelve consecutive months or a similar decline of at least 50% for three consecutive months. Each bond is reviewed to determine whether it is a general obligation bond, which is backed by the credit and taxing power of the issuing jurisdiction, or revenue bond, which is only payable from specified revenues. Based on the review undertaken by the Company and the intent and ability to hold the bonds until anticipated recovery (which may be maturity) the Company determined that the decline in value of the various bond holdings were deemed to be temporary and were the result of the general market downturns and interest rate/yield curve changes, not credit issues. Consistent with the Company's review of the portfolio as a whole, the intent and ability to hold such bonds until anticipated recovery and the fact that almost all of such bonds are general obligation bonds, the Company determined that the decline in the value of these bond holdings were deemed to be temporary.

The equity portfolio continues to feel the effects of the economic turbulence that is affecting the financial sector. This sector of the portfolio, as of September 30, 2009, held \$196,000 in unrealized losses on an amortized cost basis of \$11,266,000. However, the portfolio held \$1,005,000 in unrealized gains at September 30, 2009 with a portion of these gains related to holdings that were previously written down. The amount of the declines has caused several of our equity holdings to be deemed other than temporarily impaired resulting in a write down in value of these holdings of \$30,000 and \$4,614,000 for the three and nine months ended September 30, 2009. Certain positions may be liquidated, in whole or part, through the remainder of 2009 so that the losses can be carried back for tax purposes and offset against gains that have been recognized over the past several years.

The equity portion of the portfolio, which is invested entirely in financial institutions, is reviewed for possible other than temporary impairment in a similar manner to the bond portfolio with greater emphasis placed on the length of time the market value has been less than the carrying value and financial sector outlook. The Company also reviews dividend payment activities and, in the case of financial institutions, whether or not such issuer was participating in the TARP Capital Purchase Program. The starting point for the equity analysis is the length and severity of a market price decline. The Company monitors two primary measures: 20% decline for twelve consecutive months and 50% decline for three consecutive months in market value from carrying value.

Table of Contents

The amortized cost of investment securities and their estimated fair values at September 30, 2009 and December 31, 2008 are as follows:

	September 30, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(In Thousands)				
Available for sale (AFS)				
U.S. Government and agency securities	\$ 38,518	\$ 2,099	\$	\$ 40,617
State and political securities	144,464	4,351	(4,160)	144,655
Other debt securities	21,111	1,287	(341)	22,057
Total debt securities	204,093	7,737	(4,501)	207,329
Equity securities	11,266	1,005	(196)	12,075
Total investment securities AFS	\$ 215,359	\$ 8,742	\$ (4,697)	\$ 219,404
Held to maturity (HTM)				
U.S. Government and agency securities	\$ 9	\$ 1	\$	\$ 10
Other debt securities	101			101
Total investment securities HTM	\$ 110	\$ 1	\$	\$ 111
(In Thousands)				
December 31, 2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale (AFS)				
U.S. Government and agency securities	\$ 46,452	\$ 1,134	\$	\$ 47,586
State and political securities	142,258	348	(10,764)	131,842
Other debt securities	15,970	649	(1,065)	15,554
Total debt securities	204,680	2,131	(11,829)	194,982
Equity securities	16,429	225	(3,385)	13,269
Total investment securities AFS	\$ 221,109	\$ 2,356	\$ (15,214)	\$ 208,251
Held to maturity (HTM)				
U.S. Government and agency securities	\$ 10	\$ 1	\$	\$ 11
Other debt securities	125			125
Total investment securities HTM	\$ 135	\$ 1	\$	\$ 136

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

Table of Contents

The distribution of credit ratings by amortized cost and estimated fair values for the debt security portfolio at September 30, 2009 follows:

(In Thousands)	A- to AAA		B- to BBB+		C to CCC+		Not Rated		Total	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available for sale (AFS)										
U.S. Government and agency securities	\$ 38,518	\$ 40,617	\$	\$	\$	\$	\$	\$	\$ 38,518	\$ 40,617
State and political securities	127,182	127,861	8,308	7,991			8,974	8,803	144,464	144,655
Other debt securities	19,320	20,340	681	611			1,110	1,106	21,111	22,057
Total debt securities AFS	\$ 185,020	\$ 188,818	\$ 8,989	\$ 8,602	\$	\$	\$ 10,084	\$ 9,909	\$ 204,093	\$ 207,329
Held to maturity (HTM)										
U.S. Government and agency securities	\$ 9	\$ 10	\$	\$	\$	\$	\$	\$	\$ 9	\$ 10
Other debt securities	101	101							101	101
Total debt securities HTM	\$ 110	\$ 111	\$	\$	\$	\$	\$	\$	\$ 110	\$ 111

Financing Activities

Deposits

Total deposits increased 16.3% or \$68,694,000 from December 31, 2008 to September 30, 2009. The growth was led by a 100.3% or \$35,972,000 increase in money market deposits from December 31, 2008 to September 30, 2009. The increase in core deposits (deposits less time deposits) of 21.21% or \$47,589,000 has provided relationship driven funding for the loan portfolio, while also reducing the utilization of FHLB borrowings. The increase in deposits is the result of a deposit gathering program coupled with customers coming back to their hometown bank in the wake of the economic turbulence.

Deposit balances and their changes for the periods being discussed follow:

(In Thousands)	September 30, 2009		December 31, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
Demand deposits	\$ 75,569	15.4%	\$ 76,035	18.0%	\$ (466)	(0.6)%
NOW accounts	61,855	12.6	53,821	12.8	8,034	14.9
Money market deposits	71,820	14.7	35,848	8.5	35,972	100.3
Savings deposits	62,717	12.8	58,668	13.9	4,049	6.9
Time deposits	218,101	44.5	196,996	46.8	21,105	10.7
Total deposits	\$ 490,062	100.0%	\$ 421,368	100.0%	\$ 68,694	16.3%

Deposit balances and their changes for the periods being discussed follow:

Borrowed Funds

Total borrowed funds decreased 32.7% or \$52,506,000 to \$108,218,000 at September 30, 2009 compared to \$160,724,000 at December 31, 2008. The decrease in borrowed funds is primarily the result of growth in deposits as part of the previously discussed deposit gathering campaigns that were utilized to provide loan portfolio funding and to reduce the level of total borrowings. FHLB repurchase agreements were utilized as their structure allowed for a reduction in interest expense, while providing the ability to reduce the borrowings at our discretion as deposit levels increased.

Table of Contents

(In Thousands)	September 30, 2009		December 31, 2008		Change	
	Amount	% Total	Amount	% Total	Amount	%
Short-term borrowings:						
FHLB repurchase agreements	\$ 9,005	8.3%	\$ 61,013	38.0%	\$ (52,008)	(85.2)%
Securities sold under agreement to repurchase	12,435	11.5	12,933	8.0	(498)	(3.9)
Total short-term borrowings	21,440	19.8%	73,946	46.0%	(52,506)	(71.0)
Long-term borrowings, FHLB	86,778	80.2	86,778	54.0		
Total borrowed funds	\$ 108,218	100.0%	\$ 160,724	100.0%	\$ (52,506)	(32.7)%

Capital

The adequacy of the Company's capital is reviewed on an ongoing basis with reference to the size, composition, and quality of the Company's resources and regulatory guidelines. Management seeks to maintain a level of capital sufficient to support existing assets and anticipated asset growth, maintain favorable access to capital markets, and preserve high quality credit ratings.

Bank holding companies are required to comply with the Federal Reserve Board's risk-based capital guidelines. The risk-based capital rules are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and to minimize disincentives for holding liquid assets. Specifically, each is required to maintain certain minimum dollar amounts and ratios of total risk-based, tier I risk-based, and tier I leverage capital. In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvements Act (FDICIA) established five capital categories ranging from well capitalized to critically undercapitalized. To be classified as well capitalized, total risk-based, tier I risk-based, and tier I leverage capital ratios must be at least 10%, 6%, and 5%, respectively.

Capital ratios as of September 30, 2009 and December 31, 2008 were as follows:

Table of Contents

(In Thousands)	2009		2008	
	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-weighted Assets)				
Actual	\$ 66,553	15.0%	\$ 66,891	16.0%
For Capital Adequacy Purposes	35,541	8.0	33,410	8.0
To Be Well Capitalized	44,426	10.0	41,763	10.0
Tier I Capital (to Risk-weighted Assets)				
Actual	\$ 61,710	13.9%	\$ 62,540	15.0%
For Capital Adequacy Purposes	17,770	4.0	16,705	4.0
To Be Well Capitalized	26,656	6.0	25,058	6.0
Tier I Capital (to Average Assets)				
Actual	\$ 61,710	9.3%	\$ 62,540	9.7%
For Capital Adequacy Purposes	26,633	4.0	25,773	4.0
To Be Well Capitalized	33,292	5.0	32,216	5.0

Liquidity; Interest Rate Sensitivity and Market Risk

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

Edgar Filing: PENNS WOODS BANCORP INC - Form 10-Q

The following liquidity measures are monitored for compliance and were within the limits cited at September 30, 2009:

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

Fundamental objectives of the Company's asset/liability management process are to maintain adequate liquidity while minimizing interest rate risk. The maintenance of adequate liquidity provides the Company with the ability to meet its financial obligations to depositors, loan customers, and shareholders. Additionally, it provides funds for normal operating expenditures and business opportunities as they arise. The objective of interest rate sensitivity management is

Table of Contents

to increase net interest income by managing interest sensitive assets and liabilities in such a way that they can be repriced in response to changes in market interest rates.

The Bank, like other financial institutions, must have sufficient funds available to meet its liquidity needs for deposit withdrawals, loan commitments and originations, and expenses. In order to control cash flow, the Bank estimates future cash flows from deposits, loan payments, and investment security payments. The primary sources of funds are deposits, principal and interest payments on loans and investment securities, FHLB borrowings, and brokered deposits. Management believes the Bank has adequate resources to meet its normal funding requirements.

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

Management monitors and determines the desirable level of liquidity. Consideration is given to loan demand, investment opportunities, deposit pricing and growth potential, as well as the current cost of borrowing funds. The Company has a current borrowing capacity at the FHLB of \$208,971,000. In addition to this credit arrangement, the Company has additional lines of credit with correspondent banks of \$15,423,000. Management believes it has sufficient liquidity to satisfy estimated short-term and long-term funding needs. FHLB borrowings totaled \$95,783,000 as of September 30, 2009.

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

The Company currently maintains a GAP position of being liability sensitive. The Company has strategically taken this position as it has decreased the duration of the time deposit portfolio,

Table of Contents

while continuing to maintain a primarily fixed rate earning asset portfolio with a duration greater than the liabilities utilized to fund earning assets. Lengthening of the liability portfolio coupled with the addition of limited short-term assets is being undertaken. These actions are expected to reduce, but not eliminate, the liability sensitive structure of the balance sheet.

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

Interest Rate Sensitivity

In this analysis the Company examines the result of a 100 and 200 basis point change in market interest rates and the effect on net interest income. It is assumed that the change is instantaneous and that all rates move in a parallel manner. Assumptions are also made concerning prepayment speeds on mortgage loans and mortgage securities.

The following is a rate shock forecast for the twelve month period ended September 30, 2010 assuming a static balance sheet as of September 30, 2009.

(In Thousands)	Parallel Rate Shock in Basis Points									
	-200		-100		+100		+200			
	\$		\$	Static	\$		\$			
Net interest income		20,537		21,110		21,459		21,424		21,193
Change from static		(922)		(349)				(35)		(266)
Percent change from static		-4.30%		-1.63%				-0.16%		-1.24%

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

Inflation

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

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk for the Company is comprised primarily of interest rate risk exposure and liquidity risk. Interest rate risk and liquidity risk management is performed at the Bank level as well as the Company level. The Company's interest rate sensitivity is monitored by management through selected interest rate risk measures produced by an independent third party. There have been no substantial changes in the Company's gap analyses or simulation analyses compared to the information provided in the Annual Report on Form 10-K for the period ended December 31, 2008. Additional information and details are provided in the Liquidity and Interest Rate Sensitivity section of Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Generally, management believes the Company is well positioned to respond in a timely manner when the market interest rate outlook changes.

Item 4. Controls and Procedures

An analysis was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of September 30, 2009. There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2009, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**Part II. OTHER INFORMATION****Item 1. Legal Proceedings**

None.

Item 1A. Risk Factors

There are no material changes to the risk factors set forth in Part I, Item 1A, Risk Factors, of the Company's Annual Report on Form 10-K for the year ended December 31, 2008. Please refer to that section for disclosures regarding the risks and uncertainties related to the Company's business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Units) Purchased	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1 (July 1 - July 31, 2009)				
Month #2 (August 1 - August 31, 2009)				
Month #3 (September 1 - September 30, 2009)				

On April 28, 2009, the Board of Directors extended the previously approved authorization to repurchase up to 197,000 shares, or approximately 5%, of the outstanding shares of the Company for an additional year to April 30, 2010. To date, there have been 118,656 shares repurchased under this plan.

Item 3. Defaults Upon Senior Securities

None

Inflation

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Table of Contents

Item 6. Exhibits

- (3) (i) Articles of Incorporation of the Registrant, as presently in effect (incorporated by reference to Exhibit 3(i) of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005).
- (3) (ii) Bylaws of the Registrant as presently in effect (incorporated by reference to Exhibit 3(ii) of the Registrant's Current Report on Form 8-K filed June 17, 2005).
- (31) (i) Rule 13a-14(a)/Rule 15d-14(a) Certification of Chief Executive Officer.
- (31) (ii) Rule 13a-14(a)/Rule 15d-14(a) Certification of Chief Financial Officer.
- (32) (i) Section 1350 Certification of Chief Executive Officer.
- (32) (ii) Section 1350 Certification of Chief Financial Officer.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PENNS WOODS BANCORP, INC.
(Registrant)

Date: November 9, 2009

/s/ Ronald A. Walko
Ronald A. Walko, President and Chief Executive Officer
(Principal Executive Officer)

Date: November 9, 2009

/s/ Brian L. Knepp
Brian L. Knepp, Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit 31(i)	Rule 13a-14(a)/Rule 15d-14(a) Certification of Chief Executive Officer
Exhibit 31(ii)	Rule 13a-14(a)/Rule 15d-14(a) Certification of Chief Financial Officer
Exhibit 32(i)	Section 1350 Certification of Chief Executive Officer
Exhibit 32(ii)	Section 1350 Certification of Chief Financial Officer