

PENNS WOODS BANCORP INC  
Form 10-K  
March 12, 2010  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC. 20549

**FORM 10-K**

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

**For the fiscal year ended December 31, 2009**

**OR**

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

**Commission file number 0-17077**

**PENNS WOODS BANCORP, INC.**

**Pennsylvania**  
(State or other  
jurisdiction of incorporation or  
organization)

**23-2226454**  
(I.R.S.  
Employer Identification  
No.)

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

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

**17703-0967**

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

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

<b>Title of each class</b>	<b>Name of each exchange which registered</b>
<b>Common Stock, par value \$8.33 per share</b>	<b>The NASDAQ Stock Market LLC</b>

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

**None**

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

(Title of Class)

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

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

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

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

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

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

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

(Do not check if a smaller reporting company)

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

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

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

Class  
Common Stock, \$8.33 Par Value

Outstanding at March 2, 2010  
3,834,475 Shares



Table of Contents

**DOCUMENTS INCORPORATED BY REFERENCE**

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

**INDEX**

	<b>PAGE</b>
<b><u>PART I</u></b>	
ITEM	
<u>Item 1. Business</u>	3
<u>Item 1A. Risk Factors</u>	8
<u>Item 1B. Unresolved Staff Comments</u>	10
<u>Item 2. Properties</u>	10
<u>Item 3. Legal Proceedings</u>	11
<u>Item 4. (Removed and Reserved)</u>	11
<b><u>PART II</u></b>	
<u>Item 5. Market for the Registrant's Common Stock, Related Stockholder Matters, and Issuer Purchase of Equity Securities</u>	11
<u>Item 6. Selected Financial Data</u>	13
<u>Item 7. Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations</u>	15
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	32
<u>Item 8. Financial Statements and Supplementary Data</u>	33
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	68
<u>Item 9A. Controls and Procedures</u>	68
<u>Item 9B. Other Information</u>	70
<b><u>PART III</u></b>	
<u>Item 10. Directors and Executive Officers of the Registrant</u>	70
<u>Item 11. Executive Compensation</u>	70
<u>Item 12. Security Ownership and Certain Beneficial Owners and Management and Related Stockholder Matters</u>	70
<u>Item 13. Certain Relationships and Related Transactions</u>	70
<u>Item 14. Principal Accountant Fees and Services</u>	70
<b><u>PART IV</u></b>	
<u>Item 15. Exhibits and Financial Statement Schedules</u>	71
<u>Index to Exhibits</u>	71
<u>Signatures</u>	72
<u>Exhibits</u>	72

Table of Contents

**PART I**

**ITEM 1 BUSINESS**

**A. General Development of Business and History**

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

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

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

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

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

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

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

## **B. Regulation and Supervision**

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

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

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

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

Table of Contents

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

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

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

**Dividends**

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

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

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

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



### **C. Regulation of the Bank**

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

### **Prompt Corrective Action**

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

Table of Contents

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

**Deposit Insurance**

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

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

**Federal Home Loan Bank System**

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

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

**Other Legislation**

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

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

Table of Contents

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

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

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

**Environmental Laws**

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

**Effect of Government Monetary Policies**

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

**DESCRIPTION OF BANK**

## History and Business

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

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

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

Table of Contents

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

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

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

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

**Supervision and Regulation**

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

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

**ITEM 1A RISK FACTORS**

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

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



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

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

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

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

Table of Contents

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

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

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

**Competition may decrease our growth or profits.**

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

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

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

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

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

### **We may be adversely affected by government regulation.**

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

Table of Contents

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

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

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

**Environmental liability associated with lending activities could result in losses.**

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

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

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

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

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

**ITEM 1B UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2 PROPERTIES**

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

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

Table of Contents

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

**ITEM 3      LEGAL PROCEEDINGS**

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

**ITEM 4      (REMOVED AND RESERVED)****PART II**

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

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

Table of Contents

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

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

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

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

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

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



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

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

Table of Contents

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

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

**ITEM 6 SELECTED FINANCIAL DATA**

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

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

Table of Contents

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

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

Table of Contents

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

**RESULTS OF OPERATIONS**



**NET INTEREST INCOME**

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

**2009 vs 2008**

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

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

**2008 vs 2007**

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

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

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



Table of Contents**AVERAGE BALANCES AND INTEREST RATES**

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

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



Table of Contents

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

**Reconciliation of Taxable Equivalent Net Interest Income**

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

**Rate/Volume Analysis**

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

Table of Contents

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

**PROVISION FOR LOAN LOSSES**



**2009 vs 2008**

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

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

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

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

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

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

Table of Contents

**2008 vs 2007**

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

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

Table of Contents

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

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

**NON-INTEREST INCOME**





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

2009 vs 2008

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

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

2008 vs 2007

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

Table of Contents

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

**NON-INTEREST EXPENSE**



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

2009 vs 2008

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

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

**2008 vs 2007**

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

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

**INCOME TAXES**



**2009 vs 2008**

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



Table of Contents

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

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

**2008 vs 2007**

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

**FINANCIAL CONDITION**



**INVESTMENTS**



## 2009

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

## 2008

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

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

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



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

Table of Contents

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

(In Thousands)	Within One Year	After One But Within Five Years	After Five But Within Ten Years	After Ten Years	Amortized Cost Total
U.S. Government agencies:					
HTM Amount	\$	\$	\$	\$ 6	\$ 6
Yield				8.62%	8.62%
AFS Amount				37,038	37,038
Yield				5.82%	5.82%
State and political subdivisions (tax-exempt):					
HTM Amount					
Yield					
AFS Amount			1,454	111,159	112,613
Yield			7.98%	6.60%	6.61%
State and political subdivisions (taxable):					
HTM Amount					
Yield					
AFS Amount		1,007		40,294	41,301
Yield		6.01%		5.98%	5.98%
Other bonds, notes and debentures:					
HTM Amount	25	76			101
Yield	7.31%	6.30%			6.55%
AFS Amount	25	10,349	1	1,896	12,271
Yield	0.66%	5.11%	0.90%	6.82%	5.37%
Total Amount	\$ 50	\$ 11,432	\$ 1,455	\$ 190,393	\$ 203,330
Total Yield	3.99%	5.20%	7.97%	6.32%	6.27%
Equity Securities					\$ 10,959
Total Investment Portfolio Value					\$ 214,289
Total Investment Portfolio Yield					5.94%

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

The distribution of credit ratings by amortized cost and estimated fair value for the debt security portfolio at December 31, 2009 is as follows:

(In Thousands)	A- to AAA		B- to BBB+		C to CCC+		Not Rated		Total	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale (AFS)										
U.S. Government and agency securities										
	\$ 37,038	\$ 39,136	\$	\$	\$	\$	\$	\$	\$ 37,038	\$ 39,136
State and political securities										
	136,585	129,219	8,340	7,370			8,989	8,288	153,914	144,877

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

Other debt securities	10,915	11,624	400	355	956	997	12,271	12,976
Total debt securities AFS	\$ 184,538	\$ 179,979	\$ 8,740	\$ 7,725	\$ 9,945	\$ 9,285	\$ 203,223	\$ 196,989
<b>Held to maturity (HTM)</b>								
U.S. Government and agency securities	\$ 6	\$ 6	\$	\$	\$	\$	\$ 6	\$ 6
Other debt securities	101	102					101	102
Total debt securities HTM	\$ 107	\$ 108	\$	\$	\$	\$	\$ 107	\$ 108



Table of Contents

**LOAN PORTFOLIO**



**2009**

Gross loans of \$405,529,000 at December 31, 2009 represented an increase of \$24,051,000 from December 31, 2008. The continued emphasis on well collateralized real estate loans resulted in commercial real estate secured loans increasing \$16,051,000 from December 31, 2008 to 2009. The success in carrying out this long term strategy has played a significant role in limiting net charge-offs for 2009 to 0.16% of average loans. The composition of the portfolio has shifted toward commercial from residential since December 31, 2008. This shift is the by-product of the majority of residential mortgages being sold into the secondary market versus being added to the loan portfolio.

**2008**

Gross loans of \$381,478,000 at December 31, 2008 represented an increase of \$21,000,000 from December 31, 2007. The continued emphasis on well collateralized real estate loans resulted in real estate secured loans increasing \$17,039,000 from December 31, 2007 to 2008. The success in carrying out this long term strategy has played a significant role in limiting net chargeoffs for 2008 to 0.04% of average loans. Despite the softening economy, the Bank has increased outstanding loans while maintaining its lending practices and is capitalizing on opportunities because larger regional banks have withdrawn, in part, from select market segments.

The amounts of loans outstanding at the indicated dates are shown in the following table according to type of loan at December 31, 2009, 2008, 2007, 2006, and 2005:

(In Thousands)	2009		2008		2007		2006		2005	
	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total
Commercial, financial and agricultural	\$ 46,647	11.5%	\$ 40,602	10.6%	\$ 35,739	9.9%	\$ 36,995	10.3%	\$ 37,553	11.1%
Real estate mortgage:										
Residential	174,346	43.1	177,406	46.5	163,268	45.3	158,219	43.9	150,000	44.3
Commercial	152,209	37.5	136,158	35.7	132,943	36.9	135,404	37.6	127,131	37.5
Construction	21,795	5.4	15,838	4.2	16,152	4.5	16,749	4.6	10,681	3.2
Installment loans to individuals	11,549	2.8	12,487	3.3	13,317	3.7	14,035	3.9	14,135	4.2
Less: Net deferred loan fees	1,017	(0.3)	1,013	(0.3)	941	(0.3)	1,018	(0.3)	1,062	(0.3)
Gross loans	\$ 405,529	100.0%	\$ 381,478	100.0%	\$ 360,478	100.0%	\$ 360,384	100.0%	\$ 338,438	100.0%

Table of Contents

The amounts of domestic loans at December 31, 2009 are presented below by category and maturity:

(In Thousands)	Real Estate	Commercial and Other	Installment Loans to Individuals	Total
Loans with floating interest rates:				
1 year or less	\$ 23,811	\$ 11,100	\$ 2,070	\$ 36,981
1 through 5 years	16,313	2,083	10	18,406
5 through 10 years	27,916	2,917	1	30,834
After 10 years	225,824	10,620	873	237,317
Total floating interest rate loans	293,864	26,720	2,954	323,538
Loans with predetermined interest rates:				
1 year or less	3,295	1,557	1,025	5,877
1 through 5 years	15,788	12,426	6,865	35,079
5 through 10 years	20,379	2,586	767	23,732
After 10 years	13,736	3,539	28	17,303
Total predetermined interest rate loans	53,198	20,108	8,685	81,991
Total	\$ 347,062	\$ 46,828	\$ 11,639	\$ 405,529

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

The Bank does not make loans that provide for negative amortization nor do any loans contain conversion features. The Bank does not have any foreign loans outstanding at December 31, 2009.

**ALLOWANCE FOR LOAN LOSSES**



2009

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio, as of the consolidated balance sheet date. All loan losses are charged to the allowance and all recoveries are credited to it per the allowance method of providing for loan losses. The allowance for loan losses is established through a provision for loan losses charged to operations. The provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Bank. Management remains committed to an aggressive program of problem loan identification and resolution.

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

The allowance for loan losses increased from \$4,356,000 at December 31, 2008 to \$4,657,000 at December 31, 2009. At December 31, 2009, the allowance for loan losses was 1.15% of total loans compared to 1.14% of total loans at December 31, 2008. This percentage is consistent with the Bank's historical experience and peer banks. Management's conclusion is that the allowance for loan losses is adequate to provide for probable losses inherent in its loan portfolio as of the balance sheet date.

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

Table of Contents**2008**

At December 31, 2008, the allowance for loan losses as a percent of total loans decreased to 1.14% from 1.15% at December 31, 2007. An increase in gross loans of \$21,000,000 from \$360,478,000 at December 31, 2007 to \$381,478,000 at December 31, 2008 coupled with net charge-offs of \$149,000 led to the slight decline in the allowance for loan losses as a percent of total loans.

**Allocation In The Allowance For Loan Losses**

(In Thousands)	Amount	Percent Of Loan In Each Category To Total Loans
<b>December 31, 2009:</b>		
Balance at end of period applicable to:		
Commercial and agricultural	\$ 566	11.5%
Real estate mortgage:		
Residential	968	42.9%
Commercial	1,484	37.4%
Construction	1,396	5.4%
Installment loans to individuals	221	2.8%
Unallocated	22	
Total	\$ 4,657	100.0%
<b>December 31, 2008:</b>		
Balance at end of period applicable to:		
Commercial and agricultural	\$ 580	10.6%
Real estate mortgage:		
Residential	659	46.4%
Commercial	1,326	35.6%
Construction	1,471	4.1%
Installment loans to individuals	250	3.3%
Unallocated	70	
Total	\$ 4,356	100.0%
<b>December 31, 2007:</b>		
Balance at end of period applicable to:		
Commercial and agricultural	\$ 823	9.9%
Real estate mortgage:		
Residential	1,031	45.1%
Commercial	1,634	36.8%
Construction	112	4.5%
Installment loans to individuals	228	3.7%
Unallocated	302	
Total	\$ 4,130	100.0%
<b>December 31, 2006:</b>		
Balance at end of period applicable to:		
Commercial and agricultural	\$ 679	10.2%
Real estate mortgage:		
Residential	951	43.8%
Commercial	1,972	37.5%

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

Construction		108	4.6%
Installment loans to individuals		295	3.9%
Unallocated		180	
Total	\$	4,185	100.0%

**December 31, 2005:**

Balance at end of period applicable to:

Commercial and agricultural	\$	582	10.1%
Real estate mortgage:			
Residential		1,107	44.2%
Commercial		1,482	37.5%
Construction		79	3.1%
Installment loans to individuals		192	5.1%
Unallocated		237	
Total	\$	3,679	100.0%



Table of Contents**NONPERFORMING LOANS**

Nonaccrual loans increased \$415,000 to \$1,891,000 at December 31, 2009 as several commercial real estate relationships deteriorated in quality. Overall nonperforming loans increased \$2,721,000 to \$4,456,000 from fiscal year end 2008 due to one commercial loan that is well secured with no loss expected at this time.

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

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

(In Thousands)	Total Nonperforming Loans		
	Nonaccrual	90 Days Past Due	Total
2009	\$ 1,891	\$ 2,565	\$ 4,456
2008	1,476	259	1,735
2007	955	365	1,320
2006	370	119	489
2005	540	63	603
2004	1,381	345	1,726
2003	827	429	1,256

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

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

1. Economic conditions and the impact on the loan portfolio.

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

## **DEPOSITS**

### **2009 vs 2008**

Total average deposits were \$476,194,000 for 2009, an increase of \$58,642,000 or 14.04% from 2008. Core deposits, which exclude time deposits, increased due to growth in average money market accounts of \$31,985,000 or 103.44%. This growth is the result of the impact of natural gas exploration throughout our market footprint and municipal account gathering efforts. Time deposits also increased due to the reasons noted previously. In addition, the Bank has continued to capitalize on its reputation of safety and soundness during this prolonged economic downturn.

### **2008 vs 2007**

Total average deposits were \$417,552,000 for 2008, an increase of \$20,344,000 or 5.12% from 2007. Core deposits, which exclude time deposits, increased due to renewed focus on deposit gathering efforts and the impact of natural gas exploration through out our market

Table of Contents

footprint. Time deposits remained stable as the Bank focused on service rather than attracting deposits purely on rate. In addition, the Bank has been able to capitalize on its reputation of safety and soundness during the events of 2008 that unsettled consumer confidence. Additionally, the FDIC temporarily raised the limit on federal deposit insurance from \$100,000 to \$250,000.

The average amount and the average rate paid on deposits are summarized below for the years ended December 31, 2009, 2008, and 2007:

(In Thousands)	2009		2008		2007	
	Average Amount	Rate	Average Amount	Rate	Average Amount	Rate
Noninterest-bearing	\$ 74,618	0.00%	\$ 73,618	0.00%	\$ 69,953	0.00%
Savings	60,815	0.51%	60,324	0.73%	58,710	0.73%
Super Now	58,591	0.87%	52,117	1.26%	46,596	1.31%
Money Market	62,906	1.95%	30,921	2.26%	23,920	2.26%
Time	219,264	2.84%	200,572	3.92%	198,029	4.73%
Total average deposits	\$ 476,194	1.74%	\$ 417,552	2.31%	\$ 397,208	2.76%

**SHAREHOLDERS EQUITY**



**2009**

Shareholders' equity increased \$5,889,000 to \$66,916,000 at December 31, 2009 compared to December 31, 2008 as accumulated other comprehensive loss was reduced by \$6,777,000. The reduction in accumulated other comprehensive loss is primarily a result of a change in unrealized losses on available for sale securities from an unrealized loss of \$8,486,000 at December 31, 2008 to an unrealized loss of \$3,569,000 at December 31, 2009. The other component in the reduction of accumulated other comprehensive loss is a decrease of \$1,860,000 in the net excess of the projected benefit obligation over the market value of the plan assets of the defined benefit pension plan, due to an increase in the market value of the plan assets caused by relative improved performance in the stock and bond markets over the past year. The current level of shareholders' equity equates to a book value per share of \$17.45 at December 31, 2009 compared to \$15.93 at December 31, 2008 and an equity to asset ratio of 9.90% at December 31, 2009. Book value per share, excluding accumulated other comprehensive loss, was \$18.88 at December 31, 2009 compared to \$19.13 at December 31, 2008. Dividends paid to shareholders were \$1.84 for each of the twelve months ended December 31, 2009 and 2008.

**2008**

Shareholders' equity decreased \$9,532,000 to \$61,027,000 at December 31, 2008 as accumulated comprehensive loss increased \$6,327,000, and \$1,371,000 in common stock was strategically repurchased as part of the previously announced stock buyback plan, while net income outpaced dividends paid. The decrease in accumulated other comprehensive income is a result of a decline in the market value of certain securities held in the investment portfolio at December 31, 2008 compared to December 31, 2007, resulting in a net unrealized loss of \$8,486,000 at December 31, 2008 compared to a net unrealized loss of \$2,159,000 at December 31, 2007. In addition, the net excess of the projected benefit obligation over the market value of the plan assets of the defined benefit pension plan increased \$2,405,000 due to a decline in the market value of the plan assets caused by the significant downturn in the stock and bond markets over the past year. The current level of shareholders' equity equates to a book value per share of \$15.93 at December 31, 2008 compared to \$18.21 at December 31, 2007 and an equity to asset ratio of 9.35% at December 31, 2008. Book value per share, excluding accumulated other comprehensive loss, was \$19.13 at December 31, 2008 compared to \$19.12 at December 31, 2007. During the twelve months ended December 31, 2008 cash dividends of \$1.84 per share were paid to shareholders compared to \$1.79 for the comparable period of 2007.

Bank regulators have risk based capital guidelines. Under these guidelines the Company and Bank are required to maintain minimum ratios of core capital and total qualifying capital as a percentage of risk weighted assets and certain off-balance sheet items. At December 31, 2009, both the Company's and Bank's required ratios were well above the minimum ratios as follows:

	<b>Company</b>	<b>Bank</b>	<b>Minimum Standards</b>
Tier 1 capital ratio	9.3%	8.0%	4.0%
Total capital ratio	15.4%	13.4%	8.0%

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

**RETURN ON EQUITY AND ASSETS**

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



Table of Contents

	2009	2008	2007
Percentage of net income to:			
Average total assets	0.92%	1.27%	1.49%
Average shareholders' equity	9.66%	12.02%	12.14%
Percentage of dividends declared to net income	115.74%	88.67%	78.33%
Percentage of average shareholders' equity to average total assets	9.50%	10.53%	12.23%

**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-K

The following liquidity measures are monitored for compliance and were within the limits cited at December 31, 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 to increase net interest income by managing interest sensitive assets and liabilities in such a way that they can be repriced in response to changes in market interest rates.

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

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

Management monitors and determines the desirable level of liquidity. Consideration is given to loan demand, investment opportunities, deposit pricing and growth potential, as well as the current cost of borrowing funds. The Company has a current borrowing capacity at the FHLB of \$216,229,000 with \$91,933,000 utilized, leaving \$124,296,000 available. In addition to this credit arrangement, the Company has additional lines of credit with correspondent banks of \$13,845,000. The Company's management believes that it has sufficient liquidity to satisfy estimated short-term and long-term funding needs.

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



Table of Contents

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, 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 December 31, 2009 assuming a static balance sheet as of December 31, 2008.

(In Thousands)	Parallel Rate Shock in Basis Points				
	-200	-100	Static	+100	+200
Net interest income	\$ 21,612	\$ 22,308	\$ 22,651	\$ 22,569	\$ 22,301
Change from static	(1,039)	(343)		(82)	(350)
Percent change from static	-4.59%	-1.51%		-0.36%	-1.55%

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 that are not measured by a price index.

## **CRITICAL ACCOUNTING POLICIES**

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

### **Other Than Temporary Impairment of Debt and Equity Securities**

Debt and equity securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reason underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. For a full discussion of the Company's methodology of assessing impairment, refer to Note 3 of the Notes to Consolidated Financial Statements of the Annual Report on Form 10-K.

Table of Contents

**Allowance for Loan Losses**

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

Management uses historical information to assess the adequacy of the allowance for loan losses as well as the prevailing business environment; as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the Company's methodology of assessing the adequacy of the reserve for allowance for loan losses, refer to Note 1 of the Notes to Consolidated Financial Statements of the Annual Report of Form 10-K.

**Goodwill and Other Intangible Assets**

As discussed in Note 7 of the Notes to Consolidated Financial Statements of the Annual Report on Form 10-K, the Company must assess goodwill and other intangible assets each year for impairment. This assessment involves estimating cash flows for future periods. If the future cash flows were less than the recorded goodwill and other intangible assets balances, we would be required to take a charge against earnings to write down the assets to the lower value.

**Deferred Tax Assets**

We use an estimate of future earnings to support our position that the benefit of our deferred tax assets will be realized. If future income should prove non-existent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and our net income will be reduced. Our deferred tax assets are described further in Note 11 of the Notes to Consolidated Financial Statements of the Annual Report on Form 10-K.

**Pension Benefits**

Pension costs and liabilities are dependent on assumptions used in calculating such amounts. These assumptions include discount rates, benefits earned, interest costs, expected return on plan assets, mortality rates, and other factors. In accordance with GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation of future periods. While management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect the Company's pension obligations and future expense. Our pension benefits are described further in Note 12 of the Notes to Consolidated Financial Statements of the Annual Report on Form 10-K.



**CONTRACTUAL OBLIGATIONS**

The Company has various financial obligations, including contractual obligations which may require future cash payments. The following table presents, as of December 31, 2009, significant fixed and determinable contractual obligations to third parties by payment date. Further discussion of the nature of each obligation is included in the Notes to Consolidated Financial Statements of the Annual Report on Form 10-K.

(In Thousands)	One Year or Less	One to Three Years	Payments Due In Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	\$ 279,721	\$	\$	\$	\$ 279,721
Time Deposits	154,702	49,015	12,802	1,047	217,566
Repurchase agreements	13,199				13,199
Short-term borrowings, FHLB	5,155				5,155
Long-term borrowings, FHLB		35,000	15,500	36,278	86,778
Operating leases	383	613	408	1,522	2,926

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

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

This Report contains certain forward-looking statements including statements concerning plans, objectives, future events or performance and assumptions and other statements which are other than statements of historical fact. The Company wishes to caution readers that the following important factors, among others, may have affected and could in the future affect the Company's actual results

Table of Contents

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.

**ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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

Table of Contents

**ITEM 8**

**FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Board of Directors and Shareholders

Penns Woods Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Penns Woods Bancorp, Inc. (the Company) and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2008, the Company adopted Emerging Issues Task Force No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. This guidance was subsequently codified into Financial Accounting Standards Board ASC Topic 715-60, *Compensation Retirement Benefits*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 9, 2010 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Wexford, PA

March 9, 2010

Table of Contents

**PENNS WOODS BANCORP, INC.**  
**CONSOLIDATED BALANCE SHEET**

(In Thousands, Except Share Data)	December 31,	
	2009	2008
<b>ASSETS:</b>		
Noninterest-bearing balances	\$ 13,760	\$ 16,563
Interest-bearing deposits in other financial institutions	28	18
Total cash and cash equivalents	13,788	16,581
Investment securities, available for sale, at fair value	208,768	208,251
Investment securities held to maturity (fair value of \$108 and \$136)	107	135
Loans held for sale	4,063	3,622
Loans	405,529	381,478
Less: Allowance for loan losses	4,657	4,356
Loans, net	400,872	377,122
Premises and equipment, net	7,988	7,865
Accrued interest receivable	3,523	3,614
Bank-owned life insurance	14,942	14,546
Investment in limited partnerships	4,898	4,727
Goodwill	3,032	3,032
Deferred tax asset	9,491	10,879
Other assets	4,732	2,429
<b>TOTAL ASSETS</b>	<b>\$ 676,204</b>	<b>\$ 652,803</b>
<b>LIABILITIES:</b>		
Interest-bearing deposits	\$ 417,388	\$ 345,333
Noninterest-bearing deposits	79,899	76,035
Total deposits	497,287	421,368
Short-term borrowings	18,354	73,946
Long-term borrowings, Federal Home Loan Bank (FHLB)	86,778	86,778
Accrued interest payable	1,073	1,317
Other liabilities	5,796	8,367
<b>TOTAL LIABILITIES</b>	<b>609,288</b>	<b>591,776</b>
<b>SHAREHOLDERS EQUITY</b>		
Common stock, par value \$8.33, 10,000,000 shares authorized; 4,013,142 and 4,010,528 shares issued	33,443	33,421
Additional paid-in capital	18,008	17,959
Retained earnings	27,218	28,177
Accumulated other comprehensive loss:		
Net unrealized loss on available for sale securities	(3,569)	(8,486)
Defined benefit plan	(1,920)	(3,780)
Less: Treasury stock at cost, 179,028 shares	(6,264)	(6,264)
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>66,916</b>	<b>61,027</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 676,204</b>	<b>\$ 652,803</b>

See accompanying notes to the consolidated financial statements.



Table of Contents

## PENNS WOODS BANCORP, INC.

## CONSOLIDATED STATEMENT OF INCOME

(In Thousands, Except Per Share Data)	Year Ended December 31,		
	2009	2008	2007
<b>INTEREST AND DIVIDEND INCOME:</b>			
Loans including fees	\$ 25,568	\$ 25,228	\$ 26,099
Investment securities:			
Taxable	5,424	5,241	4,098
Tax-exempt	5,005	4,871	4,357
Dividend and other interest income	194	768	1,395
<b>TOTAL INTEREST AND DIVIDEND INCOME</b>	<b>36,191</b>	<b>36,108</b>	<b>35,949</b>
<b>INTEREST EXPENSE:</b>			
Deposits	8,284	9,670	10,951
Short-term borrowings	396	1,181	1,639
Long-term borrowings, FHLB	3,718	3,981	3,857
<b>TOTAL INTEREST EXPENSE</b>	<b>12,398</b>	<b>14,832</b>	<b>16,447</b>
<b>NET INTEREST INCOME</b>	<b>23,793</b>	<b>21,276</b>	<b>19,502</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>917</b>	<b>375</b>	<b>150</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>22,876</b>	<b>20,901</b>	<b>19,352</b>
<b>NON-INTEREST INCOME:</b>			
Service charges	2,200	2,289	2,246
Securities losses, net	(4,846)	(2,031)	(54)
Earnings on bank-owned life insurance	713	472	410
Gain on sale of loans	826	882	921
Insurance commissions	1,189	1,928	2,222
Other	2,205	1,916	1,733
<b>TOTAL NON-INTEREST INCOME</b>	<b>2,287</b>	<b>5,456</b>	<b>7,478</b>
<b>NON-INTEREST EXPENSE:</b>			
Salaries and employee benefits	10,189	9,634	9,078
Occupancy, net	1,266	1,288	1,306
Furniture and equipment	1,212	1,182	1,126
Pennsylvania shares tax	685	421	643
Amortization of investment in limited partnerships	567	712	761
Other	5,893	4,712	4,402
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>19,812</b>	<b>17,949</b>	<b>17,316</b>
<b>INCOME BEFORE INCOME TAX (BENEFIT) PROVISION</b>	<b>5,351</b>	<b>8,408</b>	<b>9,514</b>
<b>INCOME TAX (BENEFIT) PROVISION</b>	<b>(742)</b>	<b>405</b>	<b>637</b>
<b>NET INCOME</b>	<b>\$ 6,093</b>	<b>\$ 8,003</b>	<b>\$ 8,877</b>
<b>NET INCOME PER SHARE - BASIC</b>	<b>\$ 1.59</b>	<b>\$ 2.07</b>	<b>\$ 2.28</b>
<b>NET INCOME PER SHARE - DILUTED</b>	<b>\$ 1.59</b>	<b>\$ 2.07</b>	<b>\$ 2.28</b>

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

<b>WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC</b>	3,832,789	3,859,724	3,886,277
<b>WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED</b>	3,832,886	3,859,833	3,886,514
<b>DIVIDENDS PER SHARE</b>	1.84	1.84	1.79

See accompanying notes to the consolidated financial statements.



Table of Contents

## PENNS WOODS BANCORP, INC.

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(In Thousands, Except Per Share Data)	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TREASURY STOCK	TOTAL SHAREHOLDERS EQUITY
	SHARES	AMOUNT					
Balance, December 31, 2006	4,003,514	\$ 33,362	\$ 17,810	\$ 25,783	\$ 1,560	\$ (3,921)	\$ 74,594
Comprehensive income:							
Net income				8,877			8,877
Other comprehensive loss					(5,094)		(5,094)
Dividends declared (\$1.79 per share)				(6,953)			(6,953)
Stock options exercised	330	3	5				8
Common shares issued for employee stock purchase plan	3,090	26	73				99
Purchase of treasury stock (28,530 shares)						(972)	(972)
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 endorment split-dollar life insurance contracts							
				(437)			(437)
Comprehensive loss:							
Net income				8,003			8,003
Other comprehensive loss					(8,732)		(8,732)
Dividends declared, (\$1.84 per share)				(7,096)			(7,096)
Stock options exercised	330	3	8				11
Common shares issued for employee stock purchase plan	3,264	27	63				90
Purchase of treasury stock (47,726 shares)						(1,371)	(1,371)
Balance, December 31, 2008	4,010,528	33,421	17,959	28,177	(12,266)	(6,264)	61,027
Comprehensive income:							
Net income				6,093			6,093
Other comprehensive income					6,777		6,777
Dividends declared, (\$1.84 per share)				(7,052)			(7,052)
Common shares issued for employee stock purchase plan	2,614	22	49				71
Balance, December 31, 2009	4,013,142	\$ 33,443	\$ 18,008	\$ 27,218	\$ (5,489)	\$ (6,264)	\$ 66,916

## PENNS WOODS BANCORP, INC.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

2009	For the years ended December 31, 2008	2007
------	--	------

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

Net Income	\$	6,093	\$	8,003	\$	8,877
Other Comprehensive income (loss), net of tax:						
Change in unrealized gain (loss) on available for sale securities		1,719		(7,667)		(4,334)
Net realized loss included in net income, net of tax benefit of \$1,648, \$691, and \$18		3,198		1,340		36
		4,917		(6,327)		(4,298)
Defined benefit pension plan, net of tax:						
Net transition asset		1		(2)		(2)
Prior service cost		16		17		17
Net gain (loss)		1,843		(2,420)		(811)
Other comprehensive income (loss), net of tax		6,777		(8,732)		(5,094)
Comprehensive income (loss)	\$	12,870	\$	(729)	\$	3,783

See Accompanying Notes to the Consolidated Financial Statements

Table of Contents

PENNS WOODS BANCORP, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(UNAUDITED)

(In Thousands)	Year Ended December 31,		
	2009	2008	2007
<b>OPERATING ACTIVITIES:</b>			
Net Income	\$ 6,093	\$ 8,003	\$ 8,877
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	724	663	680
Provision for loan losses	917	375	150
Accretion and amortization of investment security discounts and premiums	(1,590)	(1,361)	(1,011)
Securities losses, net	4,846	2,031	54
Originations of loans held for sale	(34,723)	(39,456)	(43,783)
Proceeds of loans held for sale	35,108	40,930	44,206
Gain on sale of loans	(826)	(882)	(921)
Earnings on bank-owned life insurance	(713)	(472)	(410)
Increase in prepaid federal deposit insurance	(2,315)		
Other, net	(1,202)	(2,830)	(214)
Net cash provided by operating activities	6,319	7,001	7,628
<b>INVESTING ACTIVITIES</b>			
Investment securities available for sale:			
Proceeds from sales	14,757	40,169	60,485
Proceeds from calls and maturities	9,084	6,759	5,233
Purchases	(20,006)	(50,995)	(98,799)
Investment securities held to maturity:			
Proceeds from calls and maturities	29	4	12
Purchases		176	
Net increase in loans	(25,375)	(21,613)	(374)
Acquisition of bank premises and equipment	(847)	(1,754)	(717)
Proceeds from the sale of foreclosed assets	491	112	65
Purchase of bank-owned life insurance	(59)	(1,699)	(619)
Proceeds from bank-owned life insurance death benefit	376		
Investment in limited partnership	(738)		(1,250)
Proceeds from redemption of regulatory stock		4,606	5,081
Purchases of regulatory stock	(170)	(4,629)	(6,816)
Net cash used for investing activities	(22,458)	(28,864)	(37,699)
<b>FINANCING ACTIVITIES</b>			
Net increase (decrease) in interest-bearing deposits	72,055	30,982	(7,680)
Net increase in noninterest-bearing deposits	3,864	1,364	1,511
Proceeds of long-term borrowings, FHLB		10,000	40,000
Repayment of long-term borrowings, FHLB		(29,600)	(16,500)
Net (decrease) increase in short-term borrowings	(55,592)	18,631	20,618
Dividends paid	(7,052)	(7,096)	(6,953)
Issuance of common stock	71	90	99
Stock options exercised		11	8
Purchase of treasury stock		(1,371)	(972)
Net cash provided by financing activities	13,346	23,011	30,131
	(2,793)	1,148	60

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

<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>					
CASH AND CASH EQUIVALENTS, BEGINNING		16,581		15,433	15,373
CASH AND CASH EQUIVALENTS, ENDING	\$	13,788	\$	16,581	\$ 15,433

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION**

Interest paid	\$	12,642	\$	15,259	\$ 16,235
Income taxes paid		1,325		2,085	1,610
Transfer of loans to foreclosed real estate		708		464	75

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

**PENNS WOODS BANCORP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of Consolidation**

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

**Nature of Business**

The Bank engages in a full-service commercial banking business, making available to the community a wide range of financial services including, but not limited to, installment loans, credit cards, mortgage and home equity loans, lines of credit, construction financing, farm loans, community development loans, loans to non-profit entities and local government, and various types of time and demand deposits including, but not limited to, checking accounts, savings accounts, clubs, money market deposit accounts, certificates of deposit, and IRAs. Deposits are insured by the Federal Deposit Insurance Corporation (FDIC) to the extent provided by law.

The financial services are provided by the Bank to individuals, partnerships, non-profit organizations, and corporations through its twelve offices located in Clinton, Lycoming, and Centre Counties, Pennsylvania.

Woods Real Estate Development Co., Inc. engages in real estate transactions on behalf of Penns Woods Bancorp, Inc. and the Bank.

Woods Investment Company, Inc., a Delaware holding company, is engaged in investing activities.

The M Group engages in securities brokerage and financial planning services, which include the sale of life insurance products, annuities, and estate planning services.

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

Operations are managed and financial performance is evaluated on a corporate-wide basis. Accordingly, all financial service operations are considered by management to be aggregated in one reportable operating segment.

### **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, deferred tax assets and liabilities, and the valuation of real estate acquired through, or in lieu of, foreclosure on settlement of debt.

### **Cash and Cash Equivalents**

Cash equivalents include cash on hand and in banks. Interest-earning deposits mature within 90 days and are carried at cost. Net cash flows are reported for loan, deposit, and short-term borrowing transactions.

### **Restrictions on Cash and Cash Equivalents**

Based on deposit levels, the Company must maintain cash and other reserves with the Federal Reserve Bank of Philadelphia (FRB).

### **Investment Securities**

Investment securities are classified at the time of purchase, based on management s intention and ability, as securities held to maturity or securities available for sale. Debt securities acquired with the intent and ability to

Table of Contents

hold to maturity are stated at cost, adjusted for amortization of premium and accretion of discount, which are computed using the interest method and recognized as adjustments of interest income. Certain other debt securities have been classified as available for sale to serve principally as a source of liquidity. Unrealized holding gains and losses for available for sale securities are reported as a separate component of stockholders equity, net of tax, until realized. Realized security gains and losses are computed using the specific identification method for debt securities and the average cost method for marketable equity securities. Interest and dividends on investment securities are recognized as income when earned.

Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors, including, but not limited to, the length of time and extent to which the market value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security's ability to recover any decline in its market value, whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value, and a review of the Company's capital adequacy, interest rate risk position, and liquidity. The assessment of a security's ability to recover any decline in market value, the ability of the issuer to meet contractual obligations, and management's intent and ability requires considerable judgment. A decline in value that is considered to be other-than-temporary is recorded as a loss within noninterest income in the consolidated statement of income.

Investment securities fair values are based on observed market prices. Certain investment securities do not have observed bid prices and their fair value is based on instruments with similar risk elements. Since regulatory stock is redeemable at par, the Company carries it at cost.

**Loans**

Loans are stated at the principal amount outstanding, net of deferred fees, unamortized loan fees and costs, and the allowance for loan losses. Interest on loans is recognized as income when earned on the accrual method. The Company's general policy has been to stop accruing interest on loans when it is determined a reasonable doubt exists as to the collectability of additional interest. Income is subsequently recognized only to the extent that cash payments are received provided the loan is not delinquent in payment and, in management's judgment, the borrower has the ability and intent to make future principal payments.

Loan origination and commitment fees as well as certain direct loan origination costs are being deferred and amortized as an adjustment to the related loan's yield over the contractual lives of the related loans.

**Allowance for Loan Losses**

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio, as of the balance sheet date. The allowance method is used in providing for loan losses. Accordingly, all loan losses are charged to the allowance and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses charged to operations. The provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Bank. Management remains committed to an aggressive program of problem loan identification and resolution.

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

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

Although management believes that it uses the best information available to make such determinations and that the allowance for loan losses is adequate at December 31, 2009, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy, rising unemployment, or negative performance trends in financial information from borrowers could be indicators of subsequent increased levels of nonperforming assets and possible charge-offs, which would normally require increased loan loss provisions. An integral part of the periodic regulatory examination process is the review of the adequacy of the Bank's loan loss allowance. The regulatory agencies could require the Bank, based on their evaluation of information available at the time of their examination, to provide additional loan loss provisions to further supplement the allowance.



## Table of Contents

Impaired loans are commercial and commercial real estate loans for which it is probable the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Bank individually evaluates such loans for impairment and does not aggregate loans by major risk classifications. The definition of impaired loans is not the same as the definition of nonaccrual loans, although the two categories overlap. The Bank may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired if the loan is not a commercial or commercial real estate loan. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for these types of loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower's prior payment record, and the amount of shortfall in relation to the principal and interest owed.

## Loans Held for Sale

In general, fixed rate residential mortgage loans originated by the Bank are held for sale and are carried at cost due to their short holding period, which can range from less than two weeks to a maximum of thirty days. Sold loans are not serviced by the Bank. Proceeds from the sale of loans in excess of the carrying value are accounted for as a gain. Total gains on the sale of loans are shown as a component of non-interest income within the consolidated statement of income.

## Foreclosed Assets Held for Sale

Foreclosed assets held for sale are carried at the lower of cost or fair value less estimated selling costs. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for loan losses, if necessary. Any subsequent write-downs are charged against operating expenses. Net operating expenses and gains and losses realized from disposition are included in non-interest expense and income, respectively.

## Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using straight-line and accelerated methods over the estimated useful lives of the related assets, which range from five to ten years for furniture, fixtures, and equipment and fifteen to forty years for buildings and improvements. Costs incurred for routine maintenance and repairs are charged to operations as incurred. Costs of major additions and improvements are capitalized.

**Bank-Owned Life Insurance**

The Company has purchased life insurance policies on certain officers and directors. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized. Increases in the cash surrender value are recognized as a component of non-interest income within the consolidated statement of income.

**Endorsement Split-Dollar Life Insurance Arrangements**

On January 1, 2008, the Company changed its accounting policy and recognized a cumulative-effect adjustment to retained earnings totaling \$437,000 related to account for certain endorsement split-dollar life insurance arrangements in connection with the adoption of Emerging Issues Task Force Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements*. This statement was subsequently codified into Financial Accounting Standard Board ( FASB ) ASC Topic 715-60 *Compensation Retirement Benefits*.

**Goodwill**

The Company performs an annual impairment analysis of goodwill for its purchased subsidiary, The M Group. Based on the fair value of this reporting unit, estimated using the expected present value of future cash flows, no

Table of Contents

impairment of goodwill was recognized in 2009 and 2008.

**Investments in Limited Partnerships**

The Company is a limited partner in four partnerships at December 31, 2009 that provide low income elderly housing in the Company's geographic market area. The carrying value of the Company's investments in limited partnerships was \$4,898,000 at December 31, 2009 and \$4,727,000 at December 31, 2008. The Company is fully amortizing the investment in the partnership entered into prior to 2005 over the fifteen-year holding period. The partnerships entered into after 2004 are being fully amortized over the ten-year tax credit receipt period utilizing the straight-line method. The partnerships are amortized once the projects reach the level of occupancy needed to begin the ten year tax credit recognition period. Amortization of limited partnership investments amounted to \$567,000 in 2009, \$712,000 in 2008, and \$761,000 in 2007.

**Off-Balance Sheet Financial Instruments**

In the ordinary course of business, the Company enters into off-balance sheet financial instruments. Those instruments consist of commitments to extend credit and standby letters of credit. When those instruments are funded or become payable, the Company reports the amounts in its financial statements.

**Advertising Cost**

Advertising costs are generally expensed as incurred.

**Income Taxes**

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

Deferred tax assets and liabilities result from temporary differences in financial and income tax methods of accounting, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company analyzed its deferred tax asset position and determined that there was not a need for a valuation allowance due to the Company's ability to generate future ordinary and capital taxable income.

### **Earnings Per Share**

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated utilizing net income as reported in the numerator and weighted average shares outstanding in the denominator. The computation of diluted earnings per share differs in that the dilutive effects of any stock options are adjusted in the denominator.

### **Employee Benefits**

Pension and employee benefits include contributions, determined actuarially, to a defined benefit retirement plan covering the eligible employees of the Bank. The plan is funded on a current basis to the extent that it is deductible under existing federal tax regulations. Pension and other employee benefits also include contributions to a defined contribution Section 401(k) plan covering eligible employees. Contributions matching those made by eligible employees are funded throughout the year. In addition, an elective contribution is made annually at the discretion of the Board of Directors.

### **The M Group Products and Income Recognition**

The M Group product line is comprised primarily of annuities, life insurance, and mutual funds. The revenues generated from life insurance sales are commission only, as The M Group does not underwrite the policies. Life insurance sales include permanent and term policies with the majority of the policies written being permanent. Term life insurance policies are written for 10, 15, 20, and 30 year terms with the majority of the policies being written for 20 years. None of these products are offered as an integral part of lending activities.

Table of Contents

Commissions from the sale of annuities are recognized at the time notice is received from the third party broker/dealer or an insurance company that the transaction has been accepted and approved, which is also the time when commission income is received.

Life insurance commissions are recognized at varying points based on the payment option chosen by the customer. Commissions from monthly and annual payment plans are recognized at the start of each annual period for the life insurance, while quarterly and semi-annual premium payments are recognized quarterly and semi-annually when the earnings process is complete. For example, semi-annual payments on the first of January and July would result in commission income recognition on the first of January and July, while payments on the first of January, April, July, and October would result in commission income recognition on those dates. The potential for chargebacks only exists for those policies on a monthly payment plan since income is recognized at the beginning of the annual coverage period versus at the time of each monthly payment. No liability is maintained for chargebacks as these are removed from income at the time of the occurrence.

**Stock Options**

The Company maintains a stock option plan for directors and certain officers and employees with the last option grant being in 2000. All options were granted when the exercise price of the Company's stock options was greater than or equal to the market price of the underlying stock on the date of the grant, therefore, no compensation expense was recognized in the Company's financial statements.

**Accumulated Other Comprehensive Income**

The Company is required to present accumulated other comprehensive income in a full set of general-purpose financial statements for all periods presented. Accumulated other comprehensive income is comprised of unrealized holding gains (losses) on the available for sale securities portfolio and the unrecognized components of net periodic benefit costs of the defined benefit pension plan.

**Segment Reporting**

ASC 280, *Segment Reporting*, requires that public business enterprises report financial and descriptive information about their reportable operating segments. Based on the guidance provided by the standard, the Company has determined that its only reportable segment is Community Banking.

**Reclassification of Comparative Amounts**

Certain items previously reported have been reclassified to conform to the current year's reporting format. Such reclassifications did not affect net income or shareholders' equity.

**Recent Accounting Pronouncements**

On December 30, 2008, the FASB issued new authoritative accounting guidance under ASC Topic 715, *Compensation Retirement Benefits*, which provides guidance related to an employer's disclosures about plan assets of defined benefit pension or other post-retirement benefit plans. Under ASC Topic 715, disclosures should provide users of financial statements with an understanding of how investment allocation decisions are made, the factors that are pertinent to an understanding of investment policies and strategies, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period and significant concentrations of risk within plan assets. This guidance is effective fiscal year ending after December 15, 2009. The new authoritative accounting guidance under ASC Topic 715 became effective for the Company's financial statements for the year ended December 31, 2009 and the required disclosures are reported in Note 12.

In April 2009, the FASB issued new authoritative accounting guidance under ASC Topic 805, *Business Combinations*, which became effective for periods beginning after December 15, 2008. ASC Topic 805 applies to all transactions and other events in which one entity obtains control over one or more other businesses. ASC Topic 805 requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under previous accounting guidance whereby the cost of an acquisition was allocated to the individual assets

Table of Contents

acquired and liabilities assumed based on their estimated fair value. ASC Topic 805 requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under prior accounting guidance. Assets acquired and liabilities assumed in a business combination that arise from contingencies are to be recognized at fair value if fair value can be reasonably estimated. If fair value of such an asset or liability cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with ASC Topic 450, *Contingencies*. Under ASC Topic 805, the requirements of ASC Topic 420, *Exit or Disposal Cost Obligations*, would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of ASC Topic 450, *Contingencies*. The adoption of this new guidance did not have a material impact on the Company's financial position or results of operations.

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.

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 or results of operations.

In June 2009, the 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 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.

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, *Transfers and Servicing*. 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 adoption of this new guidance did not have a material impact on the Company's financial position or results of operations.

The FASB issued new authoritative accounting guidance under ASC Topic 855, *Subsequent Events*, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC Topic 855 defines (i) the period after the balance sheet date during which a reporting entity's management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. The new authoritative accounting guidance under ASC Topic 855 is effective for periods ending after June 15, 2009. The required disclosures are provided in Note 24.

**NOTE 2 - PER SHARE DATA**

There are no convertible securities which would affect the denominator in calculating basic and dilutive earnings per share; therefore, 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.

	2009	2008	2007
Weighted average common shares issued	4,011,817	4,008,553	4,005,181
Average treasury stock shares	(179,028)	(148,829)	(118,904)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	3,832,789	3,859,724	3,886,277
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	97	109	237
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	3,832,886	3,859,833	3,886,514

Options to purchase 990, 1,980, and 10,913 shares of common stock at a range in price of \$24.72 to \$31.82 were outstanding at December 31, 2009, 2008, and 2007, respectively. The options were included in the computation of diluted earnings per share on a weighted average basis determined by the length of time during each period that the market value exceeded the strike price.



Table of Contents**NOTE 3 - INVESTMENT SECURITIES**

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

(In Thousands)	Amortized Cost	2009		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
<b>Available for sale (AFS)</b>				
U.S. Government and agency securities	\$ 37,038	\$ 2,098	\$	\$ 39,136
State and political securities	153,914	733	(9,770)	144,877
Other debt securities	12,271	834	(129)	12,976
Total debt securities	203,223	3,665	(9,899)	196,989
Equity securities	10,952	981	(154)	11,779
Total investment securities AFS	\$ 214,175	\$ 4,646	\$ (10,053)	\$ 208,768

<b>Held to maturity (HTM)</b>				
U.S. Government and agency securities	\$ 6	\$	\$	\$ 6
Other debt securities	101	1		102
Total investment securities HTM	\$ 107	\$ 1	\$	\$ 108

(In Thousands)	Amortized Cost	2008		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
<b>Available for sale (AFS)</b>				
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

<b>Held to maturity (HTM)</b>				
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 fair value, aggregated by investment category and length of time, that the individual securities have been in a continuous unrealized loss position, at December 31, 2009 and 2008.

(In Thousands)	Less than Twelve Months		2009 Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Government and agency securities	\$	\$	\$	\$	\$	\$
State and political securities	60,005	2,336	36,267	7,434	96,272	9,770
Other debt securities			1,191	129	1,191	129
Total debt securities	60,005	2,336	37,458	7,563	97,463	9,899
Equity securities	159	27	918	127	1,077	154
Total	\$ 60,164	\$ 2,363	\$ 38,376	\$ 7,690	\$ 98,540	\$ 10,053

(In Thousands)	Less than Twelve Months		2008 Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	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

At December 31, 2009 and 2008 there were 86 and 95 individual securities in a continuous unrealized loss position for less than twelve months and 106 and 184 individual securities in a continuous unrealized loss position for greater than twelve months, respectively.

There are 192 and 279 positions that are considered temporarily impaired as of December 31, 2009 and 2008 respectively. The Company reviews its position quarterly and has asserted that at December 31, 2009 and 2008, the declines outlined in the above table represent temporary declines and the Company does not intend to sell and does not believe they will be required to sell these securities before recovery of their cost basis, which may be at maturity. The Company has concluded that any impairment of its investment securities portfolio is not other than temporary but is the result of interest rate changes that are not expected to result in the noncollection of principal and interest during the period.

The amortized cost and fair value of debt securities at December 31, 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.

Available for Sale  
Amortized

Held to Maturity  
Amortized

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

(In Thousands)	Cost		Fair Value		Cost		Fair Value	
Due in one year or less	\$	25	\$	25	\$	25	\$	25
Due after one year to five years		11,355		12,172		76		77
Due after five years to ten years		1,456		1,472				
Due after ten years		190,387		183,320		6		6
Total	\$	203,223	\$	196,989	\$	107	\$	108

Total gross proceeds from sales of securities available for sale were \$14,757,000, \$40,169,000, and \$60,485,000 for 2009, 2008, and 2007, respectively. The following table represents gross realized gains and losses on those transactions in addition to impairment charges related to the equity securities portfolio:

Table of Contents

(In Thousands)	2009		2008		2007	
Gross realized gains:						
U.S. Government and agency securities	\$		\$	253	\$	68
State and political securities				236		840
Other debt securities		575		6		2
Equity securities		22		539		772
Total gross realized gains	\$	597	\$	1,034	\$	1,682
Gross realized losses:						
U.S. Government and agency securities	\$		\$	36	\$	902
State and political securities				204		
Other debt securities		1,062		510		
Equity securities		4,381		2,315		834
Total gross realized losses	\$	5,443	\$	3,065	\$	1,736

Gross realized losses for the equity securities portfolio include impairment charges of \$4,614,000, \$2,797,000 and \$834,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

Investment securities with a carrying value of approximately \$97,366,000 and \$102,362,000 at December 31, 2009 and 2008, respectively, were pledged to secure certain deposits, repurchase agreements, and for other purposes as required by law.

There is no concentration of investments that exceed ten percent of shareholders' equity for any individual issuer, excluding those guaranteed by the U.S. Government.

**NOTE 4 - FEDERAL HOME LOAN BANK STOCK**

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 December 31, 2009, the Bank held \$7,271,000 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.

Table of Contents

Based on its analysis of these factors, the Company determined that its holding of FHLB stock was not impaired on December 31, 2009.

**NOTE 5 LOANS**

Major loan classifications as of December 31, 2009 and 2008 are summarized as follows:

(In Thousands)	Current	Past Due 30 To 90 Days	2009 Past Due 90 Days Or More & Still Accruing	Non- Accrual	Total
Commercial and agricultural	\$ 45,930	\$ 457	\$ 182	\$ 78	\$ 46,647
Real estate mortgage:					
Residential	165,313	7,333	951	749	174,346
Commercial	147,455	2,860	1,429	465	152,209
Construction	18,247	2,992		556	21,795
Installment loans to individuals	11,192	311	3	43	11,549
	388,137	\$ 13,953	\$ 2,565	\$ 1,891	406,546
Less: Net deferred loan fees	1,017				1,017
Allowance for loan losses	4,657				4,657
Loans, net	\$ 382,463				\$ 400,872

(In Thousands)	Current	Past Due 30 To 90 Days	2008 Past Due 90 Days Or More & Still Accruing	Non- Accrual	Total
Commercial and agricultural	\$ 40,006	\$ 517	\$	\$ 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



Table of Contents

Impaired loans totaled \$8,312,000 and \$5,042,000 at December 31, 2009 and 2008, respectively with \$5,343,000 and \$4,066,000 not having a specific allocation within the allowance for loan losses. . The portion of the allowance for loan losses allocated for impaired loans was \$802,000 and \$166,000 at December 31, 2009 and 2008, respectively. The average recorded investment in impaired loans during the years ended December 31, 2009 and 2008 was approximately \$6,699,000 and \$3,410,000, respectively.

The Company recognized interest income on impaired loans in the amount of \$278,000 and \$123,000 for the years ended December 31, 2009 and 2008, respectively. On a cash basis, interest income on impaired loans amounted to \$36,000 and \$7,000 for the years ended December 31, 2009 and 2008, respectively.

No additional funds are committed to be advanced in connection with impaired loans.

Loans on which the accrual of interest has been discontinued or reduced, exclusive of impaired loans, amounted to approximately \$1,891,000 and \$1,476,000 at December 31, 2009 and 2008, respectively. If interest had been recorded based on the original loan agreement terms and rate of interest for those loans, income would have approximated \$134,000, \$72,000, and \$87,000 for the years ended December 31, 2009, 2008, and 2007, respectively. Interest income on such loans, is recorded as received and amounted to approximately \$48,000, \$9,000, and \$17,000 for the years ended December 31, 2009, 2008, and 2007, respectively.

Changes in the allowance for loan losses for the years ended December 31, 2009, 2008, and 2007 are as follows:

(In Thousands)	2009	2008	2007
Balance, beginning of year	\$ 4,356	\$ 4,130	\$ 4,185
Provision charged to operations	917	375	150
Loans charged off	(732)	(313)	(304)
Recoveries	116	164	99
Balance, end of year	\$ 4,657	\$ 4,356	\$ 4,130

The Company has a concentration of loans to both owners of commercial and residential rental properties at December 31, 2009 and 2008 of 15.26% and 15.07% and 15.62% and 14.67% of total loans, respectively.

The Company grants commercial, industrial, residential, and installment loans to customers throughout north-central Pennsylvania. Although the Company has a diversified loan portfolio at December 31, 2009 and 2008, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within this region.

**NOTE 6 - PREMISES AND EQUIPMENT**

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

Major classifications of premises and equipment are summarized as follows at December 31, 2009 and 2008:

(In Thousands)	2009	2008
Land	\$ 1,480	\$ 1,480
Premises	7,206	6,929
Furniture and equipment	6,623	6,067
Leasehold improvements	885	871
Total	16,194	15,347
Less accumulated depreciation and amortization	8,206	7,482
Net premises and equipment	\$ 7,988	\$ 7,865

Depreciation and amortization charged to operations for the years ended 2009, 2008, and 2007 was \$724,000, \$663,000, and \$680,000, respectively.

Table of Contents**NOTE 7 - GOODWILL**

As of December 31, 2009, 2008, and 2007 goodwill had a gross carrying value of \$3,308,000 and accumulated amortization of \$276,000 resulting in a net carrying amount of \$3,032,000.

The gross carrying amount of goodwill is tested for impairment in the third quarter of each fiscal year. Based on fair value of the reporting unit, estimated using the expected present value of future cash flows, there was no evidence of impairment of the carrying amount at December 31, 2009, 2008, and 2007, respectively.

**NOTE 8 - TIME DEPOSITS**

Time deposits of \$100,000 or more totaled approximately \$79,840,000 on December 31, 2009 and \$67,356,000 on December 31, 2008. Interest expense related to such deposits was approximately \$2,336,000, \$2,894,000, and \$3,216,000, for the years ended December 31, 2009, 2008, and 2007, respectively.

At December 31, 2009, the scheduled maturities on time deposits of \$100,000 or more are as follows:

(In Thousands)	2009
Three months or less	\$ 23,707
Three months to six months	16,300
Six months to twelve months	23,321
Over twelve months	16,512
Total	\$ 79,840

Total time deposit maturities are as follows at December 31, 2009:

(In Thousands)	2009
2010	\$ 154,702
2011	34,895
2012	14,120
2013	12,117
2014	685
Thereafter	1,047
Total	\$ 217,566

**NOTE 9 - SHORT-TERM BORROWINGS**

Short-term borrowings consist of securities sold under agreements to repurchase and primarily FHLB advances, which generally represent overnight or less than six month borrowings. In addition to the outstanding balances noted below, the Bank also had additional lines of credit totaling \$15,139,000 available from correspondent banks other than the FHLB. The outstanding balances and related information for short-term borrowings are summarized as follows at December 31, 2009, 2008, and 2007:

Table of Contents

(In Thousands)	2009	2008	2007
<b>Repurchase Agreements:</b>			
Balance at year end	\$ 13,199	\$ 12,933	\$ 17,155
Maximum amount outstanding at any month end	16,008	18,839	19,058
Average balance outstanding during the year	13,664	15,840	16,746
Weighted-average interest rate:			
At year end	2.01%	2.83%	3.37%
Paid during the year	2.21%	2.83%	3.69%
<b>Open Repo Plus:</b>			
Balance at year end	\$ 5,155	\$ 61,013	\$ 38,160
Maximum amount outstanding at any month end	40,330	61,013	38,895
Average balance outstanding during the year	11,772	31,495	19,299
Weighted-average interest rate:			
At year end	0.62%	0.59%	4.32%
Paid during the year	0.71%	2.04%	5.09%
<b>Short-Term FHLB:</b>			
Balance at year end	\$	\$	\$
Maximum amount outstanding at any month end	15,000	10,000	15,000
Average balance outstanding during the year	2,205	3,210	771
Weighted-average interest rate:			
At year end			
Paid during the year	0.42%	2.58%	5.06%

Table of Contents**NOTE 10 LONG TERM BORROWINGS**

The following represents outstanding long-term borrowings with the FHLB by contractual maturities at December 31, 2009 and 2008:

(In Thousands)

Description	Maturity	Weighted-Average Interest Rate 2009	Weighted-Average Interest Rate 2008	Stated Interest Rate Range		2009	2008
				From	To		
Variable	2010	4.87%	4.87%	3.98%	6.65%	\$ 15,000	\$ 15,000
Variable	2011	4.49%	4.49%	4.25%	4.72%	10,000	10,000
Variable	2012	4.18%	4.18%	3.68%	4.43%	15,000	15,000
Variable	2013	3.74%	3.74%	3.74%	3.74%	5,000	5,000
Variable	2015	3.97%	3.97%	3.97%	3.97%	10,000	10,000
Variable	2017	4.22%	4.22%	4.15%	4.28%	20,000	20,000
Variable	2018	3.18%	3.18%	3.18%	3.18%	10,000	10,000
<b>Total Variable</b>		<b>4.18%</b>	<b>4.18%</b>			<b>85,000</b>	<b>85,000</b>
Fixed	2011	6.92%	6.92%	6.92%	6.92%	500	500
Fixed	2013	5.87%	5.87%	5.87%	5.87%	528	528
Fixed	2015	6.92%	6.92%	6.92%	6.92%	750	750
<b>Total Fixed</b>		<b>6.61%</b>	<b>6.61%</b>			<b>1,778</b>	<b>1,778</b>
<b>Total</b>		<b>4.23%</b>	<b>4.23%</b>			<b>\$ 86,778</b>	<b>\$ 86,778</b>

(In Thousands)

Year Ending December 31,	Amount	Weighted-Average Rate
2010	\$ 15,000	4.87%
2011	10,500	4.60%
2012	15,000	4.18%
2013	5,528	3.94%
2014 and after	40,750	3.95%
	<b>\$ 86,778</b>	<b>4.23%</b>

The terms of the convertible borrowings allow the FHLB to convert the interest rate to an adjustable rate based on the three month London Interbank Offered Rate ( LIBOR ) at a predetermined anniversary date of the borrowing 's origination, ranging from three months to five years. If the FHLB converts the interest rate on one of the predetermined dates, the Bank has the ability to payoff the debt on the conversion date and quarterly thereafter without incurring the customary pre-payment penalty.

The Bank maintains a credit arrangement which includes a revolving line of credit with the FHLB. Under this credit arrangement, the Bank has a remaining borrowing capacity of \$124,296,000 at December 31, 2009, which is subject to annual renewal, and typically incurs no service charges. Under terms of a blanket agreement, collateral for the FHLB borrowings must be secured by certain qualifying assets of the Bank

which consist principally of first mortgage loans and mortgage-backed securities.

**NOTE 11 - INCOME TAXES**

The following temporary differences gave rise to the net deferred tax asset position at December 31, 2009 and 2008:

Table of Contents

<b>(In Thousands)</b>	<b>2009</b>	<b>2008</b>
<b>Deferred tax assets:</b>		
Allowance for loan losses	\$ 1,583	\$ 1,481
Deferred compensation	403	402
Pension	1,148	2,014
Loan fees and costs	346	344
Investment securities allowance	1,620	548
Unrealized loss on available for sale securities	1,839	4,372
Low income housing credit carryforward	2,132	1,571
Capital loss	1,195	503
Other	296	373
<b>Total</b>	<b>10,562</b>	<b>11,608</b>
<b>Deferred tax liabilities:</b>		
Bond accretion	207	61
Depreciation	263	141
Amortization	601	526
<b>Total</b>	<b>1,071</b>	<b>728</b>
<b>Deferred tax asset, net</b>	<b>\$ 9,491</b>	<b>\$ 10,880</b>



Table of Contents

No valuation allowance was established at December 31, 2009 and 2008, because of the Company's ability to carry back capital losses to recover taxes paid in previous years and certain tax strategies, together with the anticipated future taxable income as evidenced by the Company's earning potential.

The benefit or provision for income taxes is comprised of the following for the year ended December 31, 2009, 2008, and 2007:

(In Thousands)	2009		2008		2007	
Currently payable	\$	1,360	\$	1,967	\$	1,758
Deferred benefit		(2,102)		(1,562)		(1,121)
Total (benefit) provision	\$	(742)	\$	405	\$	637

A reconciliation between the expected income tax and the effective income tax rate on income before income tax provision follows for the year ended December 31, 2009, 2008, and 2007:

(In Thousands)	2009		2008		2007	
	Amount	%	Amount	%	Amount	%
Provision at expected rate	\$ 1,819	34.0%	\$ 2,859	34.0%	\$ 3,235	34.0%
Decrease in tax resulting from:						
Tax-exempt income	(2,005)	(37.5)	(1,757)	(20.9)	(1,512)	(15.9)
Tax credits	(560)	(10.5)	(601)	(7.2)	(1,048)	(11.0)
Other, net	4	0.1	(96)	(1.1)	(38)	(0.4)
Effective income tax (benefit) provision and rate	\$ (742)	(13.9)%	\$ 405	4.8%	\$ 637	6.7%

**NOTE 12 - EMPLOYEE BENEFIT PLANS****Defined Benefit Pension Plan**

The Company has a noncontributory defined benefit pension plan (the "Plan") for all employees meeting certain age and length of service requirements that were hired prior to January 1, 2004, at which time entrance into the Plan was frozen. Benefits are based primarily on years of service and the average annual compensation during the highest five consecutive years within the final ten years of employment.

The following table sets forth the obligation and funded status as of December 31, 2009 and 2008:



Table of Contents

(In Thousands)	2009	2008
<b>Change in benefit obligation:</b>		
Benefit obligation at beginning of year	\$ 11,987	\$ 10,450
Service cost	525	546
Interest cost	679	609
Actuarial (gain) loss	(6)	(166)
Benefits paid	(293)	(210)
Other, change in actuarial assumptions	(1,563)	758
Benefit obligation at end of year	11,329	11,987
<b>Change in plan assets:</b>		
Fair value of plan assets at beginning of year	6,065	7,891
Actual return on plan assets	1,396	(2,504)
Employer contribution	805	875
Benefits paid	(312)	(210)
Adjustment to fair value of plan assets		13
Fair value of plan assets at end of year	7,954	6,065
Funded status	\$ (3,375)	\$ (5,922)
<b>Accounts recognized on balance sheet as:</b>		
Total liabilities	\$ (3,375)	\$ (5,922)
<b>Amounts not yet recognized as a component of net periodic pension cost:</b>		
Amounts recognized in accumulated other comprehensive income (loss) consist of:		
Net transition asset	\$ (7)	\$ (9)
Prior service cost	102	127
Net loss	2,814	5,609
Total	\$ 2,909	\$ 5,727

The accumulated benefit obligation for the Plan was \$9,871,000 and \$9,410,000 at December 31, 2009 and 2008, respectively.

Table of Contents

Components of Net Periodic Cost and Other Amounts Recognized in other Comprehensive Income as of December 31, 2009, 2008, and 2007 are as follows:

(In Thousands)	2009	2008	2007
Net periodic pension cost:			
Service cost	\$ 544	\$ 546	\$ 467
Interest cost	679	609	486
Expected return on plan assets	(508)	(641)	(562)
Amortization of transition asset	(3)	(3)	(3)
Amortization of prior service cost	25	25	26
Amortization of unrecognized net loss	339	57	
Net periodic benefit cost	\$ 1,076	\$ 593	\$ 414

The estimated net transition asset and prior service cost for the defined benefit pension plan that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost over the next fiscal year are \$3,000 and \$25,000, respectively.

**Assumptions**

Weighted-average assumptions used to determine benefit obligations at December 31, 2009, 2008, and 2007:

	2009	2008	2007
Discount rate	6.00%	5.75%	6.00%
Rate of compensation increase	3.00%	4.75%	5.00%

Weighted-average assumptions used to determine net periodic cost for years ended December 31, 2009, 2008, and 2007:

	2009	2008	2007
Discount rate	5.75%	6.00%	5.75%
Expected long-term return on plan assets	8.00%	8.00%	8.00%
Rate of compensation increase	4.75%	5.00%	4.75%

The expected long-term rate of return was estimated using market benchmarks by which the plan assets would outperform the market value in the future, based on historical experience adjusted for changes in asset allocation and expectations for overall lower future returns on similar investments compared to past periods.

**Plan Assets**

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

The Plan's weighted-average asset allocations at December 31, 2009 and 2008 by asset category are as follows:

Asset Category	2009	2008
Cash	0.4%	0.3%
Fixed income securities	40.0%	39.2%
Equity	59.6%	60.5%
Total	100.0%	100.0%

The investment objective for the Plan is to maximize total return with tolerance for slightly above average risk, meaning the fund is able to tolerate short-term volatility to achieve above-average returns over the long term.

Asset allocation favors equities, with target allocation of approximately 60% equity securities, 37.5% fixed income securities and 2.5% cash. Due to volatility in the market, the target allocation is not always desirable and asset allocations will fluctuate between the acceptable ranges. The equity portfolio's exposure is primarily in

Table of Contents

mid and large capitalization domestic equities with limited exposure to small capitalization and international stocks.

It is management's intent to give the investment managers flexibility, within the overall guidelines, with respect to investment decisions and their timing. However, certain investments require specific review and approval by management. Management is also informed of anticipated, significant modifications of any previously approved investment, or anticipated use of derivatives to execute investment strategies.

The following table sets forth by level, within the fair value hierarchy detailed in Note 20. Fair Value Measurements, the Plan's assets at fair value as of December 31, 2009:

(In Thousands)	December 31, 2009			
	Level I	Level II	Level III	Total
<b>Assets:</b>				
Cash and cash equivalents	\$ 34	\$	\$	\$ 34
Mutual Funds - Taxable Fixed Income	3,184			3,184
Mutual Funds - Domestic Equity	3,782			3,782
Mutual Funds - International Equity	954			954
Total assets at fair value	\$ 7,954	\$	\$	\$ 7,954

The following benefit payments that reflect expected future service, as appropriate, are expected to be paid:

(In Thousands)

**Estimated future benefit payments (in thousands):**

2010	\$ 336
2011	361
2012	532
2013	553
2014	601
2015-2019	3,404
	\$ 5,787

The company expects to contribute a minimum of \$400,000 to its Pension Plan in 2010.

**401(k) Savings Plan**

The Company also offers a 401(k) savings plan in which eligible participating employees may elect to contribute up to a maximum percentage allowable not to exceed the limits of Code Sections 401(k), 404, and 415. The Company may make matching contributions equal to a discretionary percentage that is determined by the Board of Directors. Participants are at all times fully vested in their contributions and vest over a period of five years regarding the employer contribution. Contribution expense was approximately \$112,000, \$97,000, and \$97,000 for the years ended December 31, 2009, 2008, and 2007, respectively.

**Deferred Compensation Plan**

The Company has a deferred compensation plan whereby participating directors elect to forego directors' fees paid in cash. Under this plan, the Company will make payments for a ten-year period beginning at age 65 in most cases or at death, if earlier, at which time payments would be made to their designated beneficiaries.

Table of Contents

To fund benefits under the deferred compensation plan, the Company has acquired bank-owned life insurance policies on the lives of the participating directors for which insurance benefits are payable to the Company. The Company incurred expenses related to the plan of \$96,000, \$96,000, and \$85,000 for the years ended December 31, 2009, 2008, and 2007, respectively. Benefits paid under the plan were approximately \$161,000, \$180,000, and \$125,000 in 2009, 2008, and 2007, respectively.

**NOTE 13 - EMPLOYEE STOCK PURCHASE PLAN**

Effective April 26, 2006, the Company implemented 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. There were 2,614 and 3,264 shares issued under the plan for the years ended December 31, 2009 and 2008, respectively.

**NOTE 14 - STOCK OPTIONS**

In 1998, the Company adopted the 1998 Stock Option Plan ( 1998 Plan ) for key employees and directors. Incentive stock options and nonqualified stock options may be granted to eligible employees of the Bank and nonqualified options may be granted to directors of the Company. Incentive nonqualified stock options granted under the 1998 Plan may be exercised not later than ten years after the date of grant. Each option granted under the 1998 Plan shall be exercisable only after the expiration of six months following the date of grant of such options.

A summary of the status of the Company's common stock option plans are presented below:

	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	1,980	\$ 28.27	10,913	\$ 37.60
Granted				
Exercised			(330)	31.82
Forfeited	(990)	31.82	(8,603)	39.97
Outstanding, end of year	990	24.72	1,980	28.27
Options exercisable at year-end	990	\$ 24.72	1,980	\$ 28.27

The following table summarizes information about nonqualified and incentive stock options outstanding at December 31, 2009:



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

		Outstanding			Exercisable		
Exercise Price	Shares	Average Life	Average Exercise Price	Shares	Average Exercise Price		
\$ 24.72	990	1	\$ 24.72	990	\$ 24.72		

**NOTE 15 - RELATED PARTY TRANSACTIONS**

Certain directors and executive officers of the Company and the Bank, including their immediate families and

Table of Contents

companies in which they are principal owners (more than ten percent), are indebted to the Company. Such indebtedness was incurred in the ordinary course of business on the same terms and at those rates prevailing at the time for comparable transactions with others.

A summary of loan activity with executive officers, directors, principal shareholders, and associates of such persons is listed below for the years ended December 31, 2009 and 2008:

(In Thousands)	Beginning Balance	Additions	Payments	Other Changes	Ending Balance
2009	\$ 8,942	\$ 980	\$ (1,178)	\$	\$ 8,744
2008	9,335	1,626	(1,776)	(243)	8,942

Deposits from related parties held by the Bank amounted to \$7,576,000 at December 31, 2009 and \$7,377,000 at December 31, 2008.

**NOTE 16 COMMITMENTS AND CONTINGENT LIABILITIES**

The following schedule shows future minimum rental payments under operating leases with noncancellable terms in excess of one year as of December 31, 2009:

(In Thousands)

2010	\$ 383
2011	317
2012	296
2013	227
2014	181
Thereafter	1,522
Total	\$ 2,926

The Company's operating lease obligations represent short and long-term lease and rental payments for facilities. Total rental expense for all operating leases for the years ended December 31, 2009, 2008, and 2007 were \$392,000, \$406,000, and \$423,000.

The Company is subject to lawsuits and claims arising out of its business. There are no such legal proceedings or claims currently pending or threatened other than those encountered during the normal course of business.

**NOTE 17 - 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 include 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.

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

Table of Contents

(In Thousands)	2009	2008
Commitments to extend credit	\$ 80,061	\$ 85,871
Standby letters of credit	1,334	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 18 - CAPITAL REQUIREMENTS**

Federal regulations require the Company and the Bank to maintain minimum amounts of capital. Specifically, each is required to maintain certain minimum dollar amounts and ratios of Total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average total assets.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act ( FDICIA ) established five capital categories ranging from well capitalized to critically undercapitalized. Should any institution fail to meet the requirements to be considered adequately capitalized, it would become subject to a series of increasingly restrictive regulatory actions.

As of December 31, 2009 and 2008, the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well capitalized financial institution, Total risk-based, Tier 1 risk-based, and Tier 1 leverage capital ratios must be at least 10%, 6%, and 5%, respectively.

The Company's and the Bank's actual capital ratios are presented in the following tables, which shows that both met all regulatory capital requirements.

Table of Contents**Consolidated Company**

(In Thousands)	2009		2008	
	Amount	Ratio	Amount	Ratio
<b>Total Capital</b>				
<b>(to Risk-weighted Assets)</b>				
Actual	\$ 67,738	15.4%	\$ 66,891	16.0%
For Capital Adequacy Purposes	35,094	8.0	33,410	8.0
To Be Well Capitalized	43,867	10.0	41,763	10.0
<b>Tier I Capital</b>				
<b>(to Risk-weighted Assets)</b>				
Actual	\$ 62,709	14.3%	\$ 62,540	15.0%
For Capital Adequacy Purposes	17,547	4.0	16,705	4.0
To Be Well Capitalized	26,320	6.0	25,058	6.0
<b>Tier I Capital</b>				
<b>(to Average Assets)</b>				
Actual	\$ 62,709	9.3%	\$ 62,540	9.7%
For Capital Adequacy Purposes	26,914	4.0	25,773	4.0
To Be Well Capitalized	33,642	5.0	32,216	5.0

**Bank**

(In Thousands)	2009		2008	
	Amount	Ratio	Amount	Ratio
<b>Total Capital</b>				
<b>(to Risk-weighted Assets)</b>				
Actual	\$ 58,024	13.4%	\$ 56,876	13.9%
For Capital Adequacy Purposes	34,632	8.0	32,799	8.0
To Be Well Capitalized	43,290	10.0	40,998	10.0
<b>Tier I Capital</b>				
<b>(to Risk-weighted Assets)</b>				
Actual	\$ 53,359	12.3%	\$ 52,520	12.8%
For Capital Adequacy Purposes	17,316	4.0	16,399	4.0
To Be Well Capitalized	25,974	6.0	24,599	6.0
<b>Tier I Capital</b>				
<b>(to Average Assets)</b>				
Actual	\$ 53,359	8.0%	\$ 52,520	8.3%
For Capital Adequacy Purposes	26,669	4.0	25,423	4.0
To Be Well Capitalized	33,336	5.0	31,778	5.0

Table of Contents

**NOTE 19 - REGULATORY RESTRICTIONS**

The Pennsylvania Banking Code restricts the availability of capital funds for payment of dividends by all state-chartered banks. Accordingly, at December 31, 2009, the balance in the additional paid in capital account totaling \$11,657,000 is unavailable for dividends.

The Bank is subject to regulatory restrictions, which limit its ability to loan funds to Penns Woods Bancorp, Inc. At December 31, 2009, the regulatory lending limit amounted to approximately \$8,704,000.

**Cash and Due from Banks**

Included in cash and due from banks are reserves required by the district Federal Reserve Bank of \$1,064,000 and \$1,046,000 at December 31, 2009 and 2008, respectively. The required reserves are computed by applying prescribed ratios to the classes of average deposit balances. These are held in the form of cash on hand and a balance maintained directly with the Federal Reserve Bank.

**NOTE 20 - FAIR VALUE MEASUREMENTS**

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels defined by GAAP are as follows:

- 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 includes 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: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the use of observable market data when available.

The following table presents the assets reported on the balance sheet at their fair value on a recurring basis as of December 31, 2009 and 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)	2009			Total
	Level I	Level II	Level III	
<b>Assets Measured on a Recurring Basis:</b>				
Investment securities, available for sale				
U.S. Government and agency securities	\$	\$ 39,136	\$	\$ 39,136
State and political securities		144,877		144,877
Other debt securities		12,976		12,976
Equity securities	11,779			11,779

(In Thousands)	2008			Total
	Level I	Level II	Level III	
<b>Assets Measured on a Recurring Basis:</b>				
Investment securities, available for sale				
U.S. Government and agency securities	\$	\$ 47,586	\$	\$ 47,586
State and political securities		131,842		131,842
Other debt securities		15,554		15,554
Equity securities	13,269			13,269

The following table presents the assets reported on the balance sheet at their fair value on a non-recurring basis as of December 31, 2009 and 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)	2009			Total
	Level I	Level II	Level III	
<b>Assets Measured on a Non-recurring Basis:</b>				
Impaired Loans	\$	\$ 7,510	\$	\$ 7,510
Other real estate owned		672		672

(In Thousands)	2008			Total
	Level I	Level II	Level III	
<b>Assets Measured on a Non-recurring Basis:</b>				
Impaired Loans	\$	\$ 4,876	\$	\$ 4,876
Other real estate owned		466		466

**NOTE 21 - FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company is required to disclose fair values for its financial instruments. Fair values are made at a specific point in time, based on relevant market information and information about the financial instrument. These fair values 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 values are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These fair values 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 fair values.

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 values, methods, and assumptions are set forth below for the Company's other financial instruments.

Table of Contents

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, the fair value of financial instruments would not represent the full market value of the Company.

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

(In Thousands)	2009		2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 13,788	\$ 13,788	\$ 16,581	\$ 16,581
<b>Investment securities:</b>				
Available for sale	208,768	208,768	208,251	208,251
Held to maturity	107	108	135	136
Loans held for sale	4,063	4,063	3,622	3,622
Loans, net	400,872	403,279	377,122	380,771
Bank-owned life insurance	14,942	14,942	14,546	14,546
Accrued interest receivable	3,523	3,523	3,614	3,614
<b>Financial liabilities:</b>				
Interest-bearing deposits	\$ 417,388	\$ 408,056	\$ 345,333	\$ 347,657
Noninterest-bearing deposits	79,899	79,899	76,035	76,035
Short-term borrowings	18,354	18,354	73,946	73,946
Long-term borrowings, FHLB	86,778	89,082	86,778	88,188
Accrued interest payable	1,073	1,073	1,317	1,317

**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 determined by using the quoted market price for similar securities. Regulatory stocks' fair value is equal to the carrying value.

**Loans:**

Fair values are determined 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.

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using 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.

Table of Contents

**Bank-Owned Life Insurance:**

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

**Deposits:**

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 December 31, 2009 and 2008. The fair value of certificates of deposit is based on the discounted value of contractual cash flows.

The fair values 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.

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

There is no material difference between the notional amount and the fair value of off-balance sheet items at December 31, 2009 and 2008. The contractual amounts of unfunded commitments and letters of credit are presented in Note 17.

**NOTE 22 PARENT COMPANY ONLY FINANCIAL STATEMENTS**

Condensed financial information for Penns Woods Bancorp, Inc. follows:

**CONDENSED BALANCE SHEET, DECEMBER 31,**

(In Thousands)

	2009		2008
<b>ASSETS:</b>			
Cash	\$	103	\$ 94
Investment in subsidiaries:			

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

Bank		55,117		49,327
Nonbank		11,553		11,463
Other assets		223		225
Total Assets	\$	66,996	\$	61,109
LIABILITIES AND SHAREHOLDERS' EQUITY:				
Other liabilities	\$	80	\$	82
Shareholders' equity		66,916		61,027
Total liability and shareholders' equity	\$	66,996	\$	61,109

Table of Contents**CONDENSED STATEMENT OF INCOME****FOR THE YEARS ENDED DECEMBER 31,**

(In Thousands)

	2009		2008		2007
<b>Operating income:</b>					
Dividends from subsidiaries	\$ 7,283	\$	8,763	\$	8,039
Security gains	1				
Equity in undistributed earnings of subsidiaries	(897)		(485)		1,152
<b>Operating expenses:</b>					
	(294)		(275)		(314)
Net income	\$ 6,093	\$	8,003	\$	8,877

**CONDENSED STATEMENT OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31,**

(In Thousands)

	2009		2008		2007
<b>OPERATING ACTIVITIES:</b>					
Net income	\$ 6,093	\$	8,003	\$	8,877
Adjustments to reconcile net income to net cash provided by operating activities:					
Equity in undistributed earnings of subsidiaries	897		485		(1,152)
Other, net			(43)		67
Net cash provided by operating activities	6,990		8,445		7,792
<b>INVESTING ACTIVITIES:</b>					
Investment in subsidiaries					
<b>FINANCING ACTIVITIES:</b>					
Dividends paid	(7,052)		(7,096)		(6,953)
Issuance of common stock	71		90		99
Stock options exercised			11		8
Purchase of treasury stock			(1,371)		(972)
Net cash used for financing activities	(6,981)		(8,366)		(7,818)
<b>NET INCREASE (DECREASE) IN CASH</b>					
	9		79		(26)
<b>CASH, BEGINNING OF YEAR</b>					
	94		15		41
<b>CASH, END OF YEAR</b>					
	\$ 103	\$	94	\$	15



Table of Contents**NOTE 23 CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)**

(In Thousands, Except Per Share Data)

2009	For The Three Months Ended			
	March 31,	June 30,	Sept. 30,	Dec. 31,
Interest income	\$ 8,917	\$ 9,013	\$ 9,113	\$ 9,148
Interest expense	3,080	3,208	3,168	2,942
Net interest income	5,837	5,805	5,945	6,206
Provision for loan losses	126	186	270	335
Non-interest income	1,593	1,694	1,888	1,958
Securities gains (losses), net	(2,369)	(2,086)	(507)	116
Non-interest expense	4,645	4,885	5,097	5,185
Income before income tax (benefit) provision	290	342	1,959	2,760
Income tax (benefit) provision	(549)	(490)	37	260
Net income	\$ 839	\$ 832	\$ 1,922	\$ 2,500
Earnings per share - basic	\$ 0.22	\$ 0.22	\$ 0.50	\$ 0.65
Earnings per share - diluted	\$ 0.22	\$ 0.22	\$ 0.50	\$ 0.65
<b>2008</b>	<b>March 31,</b>	<b>June 30,</b>	<b>Sept. 30,</b>	<b>Dec. 31,</b>
Interest income	\$ 9,048	\$ 8,936	\$ 9,108	\$ 9,016
Interest expense	4,167	3,780	3,595	3,290
Net interest income	4,881	5,156	5,513	5,726
Provision for loan losses	60	60	110	145
Non-interest income	1,876	1,872	1,976	1,763
Securities gains (losses), net	38	(251)	(1,504)	(314)
Non-interest expense	4,445	4,511	4,451	4,542
Income before income tax provision (benefit)	2,290	2,206	1,424	2,488
Income tax provision (benefit)	159	149	(128)	225
Net income	\$ 2,131	\$ 2,057	\$ 1,552	\$ 2,263
Earnings per share - basic	\$ 0.55	\$ 0.53	\$ 0.40	\$ 0.59
Earnings per share - diluted	\$ 0.55	\$ 0.53	\$ 0.40	\$ 0.59

**NOTE 24 SUBSEQUENT EVENTS**



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

The Company assessed events occurring subsequent to December 31, 2009 through March 9, 2010 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 March 9, 2010.

Table of Contents

**ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A CONTROLS AND PROCEDURES**

The Company, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer along with the Company's Chief Financial Officer, conducted an evaluation of the effectiveness as of December 31, 2009 of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon that evaluation, the Company's President and Chief Executive Officer along with the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2009.

There have been no changes in the Company's internal control over financial reporting during the fourth quarter of 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Management's Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Auditing Standard No. 2), or a combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course of performing their assigned functions.

Table of Contents

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009. Management's assessment did not identify any material weaknesses in the Company's internal control over financial reporting.

In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Because there were no material weaknesses discovered, management believes that, as of December 31, 2009, the Company's internal control over financial reporting was effective.

S.R. Snodgrass, A.C. an independent registered public accounting firm, has audited the consolidated financial statements included in this Annual Report on Form 10-K, as part of the audit, has issued a report, which appears below, on the effectiveness of the Company's internal control over financial reporting as of December 31, 2009.

Date: March 9, 2010

/s/ Ronald A. Walko  
Chief Executive Officer

/s/ Brian L. Knepp  
Chief Financial Officer

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

Penns Woods Bancorp, Inc.

We have audited Penns Woods Bancorp, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Penns Woods Bancorp, Inc. management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Report on Management's Assessment of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides

a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Table of Contents

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Penns Woods Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Penns Woods Bancorp, Inc. as of December 31, 2009 and 2008, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2009, and our report dated March 9, 2010, expressed an unqualified opinion.

Wexford, Pennsylvania

March 9, 2010

**ITEM 9B OTHER INFORMATION**

None.

**PART III**

**ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information appearing under the captions "The Board of Directors and Committees," "Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance," "Principal Officers of the Corporation," and "Certain Transactions" in the Company's Proxy Statement dated March 24, 2010 (the "Proxy Statement") is incorporated herein by reference.

**ITEM 11 EXECUTIVE COMPENSATION**

Information appearing under the captions Compensation of Directors, Compensation Committee Interlocks and Insider Participation, Compensation Discussion and Analysis, Compensation Committee and Benefits Committee Report, and Executive Compensation in the Proxy Statement is incorporated herein by reference.

**ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information appearing under the caption Security Ownership of Certain Beneficial Owners and Management in the Proxy Statement is incorporated herein by reference.

**ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information appearing under the captions Election of Directors and Certain Transactions in the Proxy Statement is incorporated herein by reference.

**ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information appearing in the Proxy Statement under the captions, Audit Fees, Audit-Related Fees, Tax Fees, All Other Fees, and Audit Committee Pre-Approval Policies and Procedures is incorporated herein by reference.

Table of Contents

**PART IV**

**ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a)1. Financial Statements

The following consolidated financial statements and reports are set forth in Item 8:

Report of Independent Auditors

Consolidated Balance Sheet

Consolidated Statement of Income

Consolidated Statement of Changes in Shareholders' Equity

Consolidated Statement of Cash Flows

Notes to the Consolidated Financial Statements

2. Financial Statement Schedules

Financial statement schedules are omitted because the required information is either not applicable, not required or is shown in the respective financial statements or in the notes thereto.

(b) 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 on June 17, 2005).
- (10) (i) Employment Agreement, dated August, 1991, between Jersey Shore State Bank and Ronald A. Walko (incorporated by reference to Exhibit 10.3 of the Registrant's Registration Statement on form S-4, No. 333-65821).\*
- (10) (ii) Employee Severance Benefit Plan, dated May 30, 1996, for Ronald A. Walko (incorporated by reference to Exhibit 10.4 of the Registrant's Registration Statement on form S-4, No. 333-65821).\*
- (10) (iii) Penns Woods Bancorp, Inc. 1998 Stock Option Plan (incorporated by reference to Exhibit 10.1 of the Registrant's Registration Statement on form S-4, No. 333-65821).\*
- (10) (iv) Form of First Amendment to the Jersey Shore State Bank Amendment and Restatement of the Director Fee Agreement, dated as of October 1, 2004 (incorporated by reference to Exhibit 10.7 of the Registrant's Current Report on Form 8-K filed on June 29, 2006).
- (10) (v) Consulting Agreement, dated July 18, 2005 between Hubert A. Valencik and Penns Woods Bancorp, Inc. (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on July 18, 2005).
- (10) (vi) Employment Agreement, dated January 11, 1999, among Penns Woods Bancorp, Inc., Jersey Shore State Bank and William H. Rockey (incorporated by reference to Exhibit 10.7 of the Registrant's Annual Report on 10-K filed on March 14, 2008).\*

## Edgar Filing: PENNS WOODS BANCORP INC - Form 10-K

- (21) Subsidiaries of the Registrant.
- (23) Consent of Independent Certified Public Accountants.
- (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 Principal Financial Officer.
- (32) (i) Section 1350 Certification of Chief Executive Officer.
- (32) (ii) Section 1350 Certification of Principal Financial Officer.

---

\* Denotes compensatory plan or arrangement.

### EXHIBIT INDEX

- (21) Subsidiaries of the Registrant.
- (23) Consent of Independent Certified Public Accountants.
- (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 Principal Financial Officer.
- (32) (i) Section 1350 Certification of Chief Executive Officer.
- (32) (ii) Section 1350 Certification of Principal Financial Officer.



Table of Contents

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

March 9, 2010

PENNS WOODS BANCORP, INC.

BY:

/s/ RONALD A. WALKO, President & Chief Executive Officer

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

/s/ Ronald A. Walko Ronald A. Walko, President, Chief Executive Officer and Director (Principal Executive Officer)	March 9, 2010
/s/ Brian L. Knepp Brian L. Knepp, Chief Financial Officer (Principal Financial Officer)	March 9, 2010
/s/ Michael J. Casale Michael J. Casale, Jr., Director	March 9, 2010
/s/ H. Thomas Davis, Jr. H. Thomas Davis, Jr., Director	March 9, 2010
/s/ James M. Furey II James M. Furey II, Director	March 9, 2010
/s/ D. Michael Hawbaker D. Michael Hawbaker, Director	March 9, 2010
/s/ Leroy H. Keiler III Leroy H. Keiler III, Director	March 9, 2010
/s/ R. Edward Nestlerode, Jr. R. Edward Nestlerode, Jr., Director	March 9, 2010
/s/ James E. Plummer James E. Plummer, Director	March 9, 2010
/s/ William H. Rockey William H. Rockey, Sr. Vice President & Director	March 9, 2010
/s/ Hubert A. Valencik Hubert A. Valencik, Director	March 9, 2010

