

CITIZENS & NORTHERN CORP

Form 10-Q

November 06, 2007

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

(Mark One)

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

For the quarterly period ended September 30, 2007

OR

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

For the transition period from _____ to _____.

Commission file number: 000-16084

CITIZENS & NORTHERN CORPORATION

(Exact name of Registrant as specified in its charter)

PENNSYLVANIA
(State or other jurisdiction of
incorporation or organization)

23-2451943
(I.R.S. Employer
Identification No.)

90-92 MAIN STREET, WELLSBORO, PA 16901

(Address of principal executive offices) (Zip code)

570-724-3411

(Registrant's telephone number including area code)

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

Common Stock (\$1.00 par value)

8,890,134 Shares Outstanding on October 31, 2007

CITIZENS & NORTHERN CORPORATION FORM 10-Q

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(In Thousands Except Share Data)

	September 30, 2007 (Unaudited)	December 31, 2006 (Note)
ASSETS		
Cash and due from banks:		
Noninterest-bearing	\$ 20,759	\$ 18,676
Interest-bearing	1,094	8,483
Total cash and cash equivalents	21,853	27,159
Trading securities	2,515	
Available-for-sale securities	344,310	356,665
Held-to-maturity securities	410	414
Loans, net	737,408	679,300
Bank-owned life insurance	21,336	16,388
Accrued interest receivable	5,513	5,046
Bank premises and equipment, net	28,259	23,129
Foreclosed assets held for sale	386	264
Intangible asset Core deposit intangible	1,534	336
Intangible asset Goodwill	12,072	2,809
Other assets	19,435	15,858
TOTAL ASSETS	\$1,195,031	\$1,127,368
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 122,816	\$ 105,675
Interest-bearing	704,573	654,674
Total deposits	827,389	760,349
Dividends payable	2,134	1,969
Short-term borrowings	47,879	49,258
Long-term borrowings	169,417	179,182
Accrued interest and other liabilities	7,829	6,722
TOTAL LIABILITIES	1,054,648	997,480
STOCKHOLDERS EQUITY	9,193	8,472

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Common stock, par value \$1.00 per share; authorized 20,000,000 shares in 2007 and 2006; issued 9,193,192 in 2007 and 8,472,382 in 2006		
Stock dividend distributable		1,806
Paid-in capital	42,495	27,077
Retained earnings	97,059	96,077
Total	148,747	133,432
Accumulated other comprehensive income	(3,291)	613
Unamortized stock compensation	(81)	(11)
Treasury stock, at cost:		
303,058 shares at September 30, 2007	(4,992)	
262,598 shares at December 31, 2006		(4,146)
TOTAL STOCKHOLDERS EQUITY	140,383	129,888
TOTAL LIABILITIES & STOCKHOLDERS EQUITY	\$1,195,031	\$1,127,368

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

Note: The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date but does not include all the information and notes required by U.S. generally accepted accounting principles for complete financial statements.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
CONSOLIDATED STATEMENT OF INCOME
(In Thousands, Except Per Share Data) (Unaudited)

	3 Months Ended		Fiscal Year To Date	
	Sept. 30, 2007 (Current)	Sept. 30, 2006 (Prior Year)	9 Months Ended Sept. 30, 2007 (Current)	2006 (Prior Year)
INTEREST INCOME				
Interest and fees on loans	\$ 12,929	\$ 11,046	\$ 36,889	\$ 31,907
Interest on loans to political subdivisions	369	23	1,072	967
Interest on balances with depository institutions	16	321	74	58
Interest on federal funds sold	50	146	200	242
Interest on trading securities	27		46	
Income from available-for-sale and held-to-maturity securities:				
Taxable	3,777	3,588	10,945	10,865
Tax-exempt	677	792	2,076	3,174
Dividends	213	236	691	786
Total interest and dividend income	18,058	16,152	51,993	47,999
INTEREST EXPENSE				
Interest on deposits	6,437	5,688	18,780	15,995
Interest on short-term borrowings	432	562	1,397	1,611
Interest on long-term borrowings	1,682	1,583	5,053	5,071
Total interest expense	8,551	7,833	25,230	22,677
Interest margin	9,507	8,319	26,763	25,322
Provision for loan losses		191	229	491
Interest margin after provision for loan losses	9,507	8,128	26,534	24,831
OTHER INCOME				
Trust and financial management revenue	885	726	2,506	1,784
Service charges on deposit accounts	709	560	1,824	1,523
Service charges and fees	177	130	501	304
Insurance commissions, fees and premiums	108	111	368	371
Increase in cash surrender value of life insurance	196	163	515	463
Other operating income	802	509	1,895	1,480
Total other income before net (losses) gains on available-for-sale	2,877	2,199	7,609	5,925

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securities				
Net (losses) gains on available-for-sale securities	(68)	1,602	(79)	4,250
Total other income	2,809	3,801	7,530	10,175
OTHER EXPENSES				
Salaries and wages	3,741	3,425	10,769	10,111
Pensions and other employee benefits	1,032	1,003	3,190	3,151
Occupancy expense, net	668	540	1,954	1,680
Furniture and equipment expense	708	643	2,104	1,961
Pennsylvania shares tax	236	244	707	732
Other operating expense	2,306	1,785	6,403	5,824
Total other expenses	8,691	7,640	25,127	23,459
Income before income tax provision	3,625	4,289	8,937	11,547
Income tax provision	777	1,016	1,695	2,255
NET INCOME	\$ 2,848	\$ 3,273	\$ 7,242	\$ 9,292
PER SHARE DATA:				
Net income basic	\$ 0.32	\$ 0.39	\$ 0.84	\$ 1.11
Net income diluted	\$ 0.32	\$ 0.39	\$ 0.84	\$ 1.11
Dividend per share	\$ 0.24	\$ 0.24	\$ 0.72	\$ 0.72
Number of shares used in computation basic	8,897,844	8,322,436	8,656,921	8,355,173
Number of shares used in computation diluted	8,905,827	8,344,340	8,669,444	8,382,610

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

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
Consolidated Statement of Cash Flows
(In Thousands) (Unaudited)

	9 Months Ended	
	Sept. 30, 2007	Sept. 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 7,242	\$ 9,292
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	229	491
Realized losses (gains) on available for sale securities, net	79	(4,250)
Gain on sale of foreclosed assets, net	(76)	(26)
Loss (gain) on disposition of premises and equipment	145	(35)
Depreciation expense	2,125	1,942
Loss from writedown of impaired premises and equipment		169
Accretion and amortization of securities, net	274	365
Other accretion and amortization, net	(158)	
Increase in cash surrender value of life insurance	(515)	(463)
Stock-based compensation	231	31
Amortization of core deposit intangibles	289	96
Net increase in trading securities	(2,515)	
Increase in accrued interest receivable and other assets	(1,099)	(2,302)
Increase in accrued interest payable and other liabilities	482	1,165
Net Cash Provided by Operating Activities	6,733	6,475
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from acquisition of Citizens Bancorp, Inc., net	29,941	
Proceeds from maturity of held-to-maturity securities	4	4
Proceeds from sales of available-for-sale securities	91,088	93,402
Proceeds from calls and maturities of available-for-sale securities	27,235	26,200
Purchase of available-for-sale securities	(85,847)	(62,052)
Purchase of Federal Home Loan Bank of Pittsburgh stock	(4,655)	(1,597)
Redemption of Federal Home Loan Bank of Pittsburgh stock	4,977	3,289
Net decrease (increase) in loans	1,483	(24,551)
Return of principal on limited partnership investment	238	
Purchase of premises and equipment	(2,157)	(3,220)
Proceeds from sale of premises and equipment		222
Proceeds from sale of foreclosed assets	478	603
Net Cash Provided by Investing Activities	62,785	32,300
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposits	(32,615)	(693)
Net (decrease) increase in short-term borrowings	(2,805)	28,745
Proceeds from long-term borrowings	42,500	
Repayments of long-term borrowings	(74,927)	(63,735)

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Purchase of treasury stock	(950)	(2,274)
Sale of treasury stock	88	76
Tax benefit from compensation plans		7
Dividends paid	(6,115)	(5,974)
Net Cash Used in Financing Activities	(74,824)	(43,848)
DECREASE IN CASH AND CASH EQUIVALENTS	(5,306)	(5,073)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	27,159	26,446
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 21,853	\$ 21,373

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
Consolidated Statement of Cash Flows
(In Thousands) (Unaudited) (Continued)

	9 Months Ended	
	Sept. 30, 2007	Sept. 30, 2006
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Assets acquired through foreclosure of real estate loans	\$ 417	\$ 650
Interest paid	\$ 25,278	\$22,778
Income taxes paid	\$ 1,977	\$ 1,750
ACQUISITION OF CITIZENS BANCORP, INC.:		
Cash and cash equivalents received	\$ 44,264	\$
Cash paid for acquisition	(14,323)	
Net cash received on acquisition	\$ 29,941	\$
NONCASH ASSETS RECEIVED, LIABILITIES ASSUMED AND EQUITY ISSUED FROM ACQUISITION OF CITIZENS BANCORP, INC.:		
Assets received:		
Available for sale securities	\$ 26,426	\$
Loans	60,151	
Bank-owned life insurance	4,433	
Premises and equipment	5,243	
Foreclosed assets	107	
Intangible asset core deposit intangible	1,487	
Intangible asset goodwill	9,263	
Other assets	1,567	
Total noncash assets received	\$ 108,677	\$
Liabilities assumed and equity issued:		
Deposits	\$ 99,636	\$
Short-term borrowings	1,426	
Long-term borrowings	22,753	
Other liabilities	735	
Equity issued, net	14,068	
Total noncash liabilities assumed and equity issued	\$ 138,618	\$

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

Table of Contents**CITIZENS & NORTHERN CORPORATION FORM 10-Q****Notes to Consolidated Financial Statements****1. BASIS OF INTERIM PRESENTATION**

The consolidated financial statements include the accounts of Citizens & Northern Corporation and its subsidiaries, Citizens & Northern Bank (C&N Bank), Canisteo Valley Corporation, Bucktail Life Insurance Company and Citizens & Northern Investment Corporation (collectively, the Corporation). The consolidated financial statements also include the accounts of Canisteo Valley Corporation s wholly-owned subsidiary, First State Bank, and C&N Bank s wholly-owned subsidiary, C&N Financial Services Corporation. All material intercompany balances and transactions have been eliminated in consolidation.

The financial information included herein, with the exception of the consolidated balance sheet dated December 31, 2006, is unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods.

Results reported for the three-month and nine-month periods ended September 30, 2007 might not be indicative of the results for the year ending December 31, 2007.

This document has not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation or any other regulatory agency.

2. PER SHARE DATA

Net income per share is based on the weighted-average number of shares of common stock outstanding. The number of shares used in calculating net income and cash dividends per share reflect the retroactive effect of stock dividends for all periods presented. The following data show the amounts used in computing net income per share and the weighted average number of shares of dilutive stock options. As shown in the table that follows, diluted earnings per share is computed using weighted average common shares outstanding, plus weighted-average common shares available from the exercise of all dilutive stock options, less the number of shares that could be repurchased with the proceeds of stock option exercises based on the average share price of the Corporation s common stock during the period.

	Net Income	Weighted- Average Common Shares	Earnings Per Share
Nine Months Ended September 30, 2007			
Earnings per share basic	\$7,242,000	8,656,921	\$0.84
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		109,329	
Hypothetical share repurchase at \$20.50		(96,806)	
Earnings per share diluted	\$7,242,000	8,669,444	\$0.84
Nine Months Ended September 30, 2006			
Earnings per share basic	\$9,292,000	8,355,173	\$1.11
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		139,968	
Hypothetical share repurchase at \$23.80		(112,531)	
Earnings per share diluted	\$9,292,000	8,382,610	\$1.11

Table of Contents**CITIZENS & NORTHERN CORPORATION FORM 10-Q****2. PER SHARE DATA, Continued**

	Net Income	Weighted- Average Common Shares	Earnings Per Share
Quarter Ended September 30, 2007			
Earnings per share basic	\$2,848,000	8,897,844	\$0.32
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		108,115	
Hypothetical share repurchase at \$18.93		(100,132)	
Earnings per share diluted	\$2,848,000	8,905,827	\$0.32
Quarter Ended September 30, 2006			
Earnings per share basic	\$3,273,000	8,322,436	\$0.39
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		120,591	
Hypothetical share repurchase at \$22.53		(98,687)	
Earnings per share diluted	\$3,273,000	8,344,340	\$0.39

3. COMPREHENSIVE INCOME

U.S. generally accepted accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although unrealized gains and losses on available-for-sale securities are reported as a separate component of the equity section of the balance sheet, changes in unrealized gains and losses on available-for-sale securities, along with net income, are components of comprehensive income. Also, effective December 31, 2006, the Corporation applied Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS No. 158 requires the Corporation to recognize the underfunded or overfunded status of defined benefit postretirement plans as a liability or asset in the balance sheet. Beginning in 2007, changes in accumulated other comprehensive income attributable to the impact of SFAS No. 158 on defined benefit plans are included in other comprehensive income.

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The components of comprehensive income, and the related tax effects, are as follows:

(In Thousands)	3 Months Ended		9 Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Net income	\$ 2,848	\$ 3,273	\$ 7,242	\$ 9,292
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding (losses) gains on available-for-sale securities	(2,333)	3,709	(6,026)	(898)
Reclassification adjustment for losses (gains) realized in income	68	(1,602)	79	(4,250)
Other comprehensive (loss) income before income tax	(2,265)	2,107	(5,947)	(5,148)
Income tax related to unrealized loss (gain) on securities	770	(718)	2,022	1,750
Other comprehensive (loss) gain on securities	(1,495)	1,389	(3,925)	(3,398)
Unfunded pension and postretirement obligations:				
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	11		33	
Income tax related to other comprehensive gain	(3)		(12)	
Other comprehensive gain on unfunded retirement obligations	8		21	
Total comprehensive income	\$ 1,361	\$ 4,662	\$ 3,338	\$ 5,894

4. SECURITIES

The Corporation's trading assets at September 30, 2007 were municipal bonds with an estimated fair value of \$2,515,000. The consolidated income statement includes net losses from trading assets in the nine months ended September 30, 2007 of \$24,000. This includes realized gains on the sale of trading securities of \$52,000 and a net unrealized holding loss of \$76,000. In the third quarter 2007, net gains from trading assets of \$47,000 included realized gains on the sale of trading securities of \$46,000, and a net unrealized holding gain of \$1,000. There was no trading activity in 2006.

Amortized cost and fair value of available-for-sale and held-to-maturity securities at September 30, 2007 are summarized as follows:

September 30, 2007	
Gross	Gross
Unrealized	Unrealized

(In Thousands)	Amortized Cost	Holding Gains	Holding Losses	Fair Value
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of other U.S. Government agencies	\$ 44,396	\$ 207	\$ (144)	\$ 44,459
Obligations of states and political subdivisions	62,198	217	(2,363)	60,052
Mortgage-backed securities	77,216	222	(858)	76,580
Collateralized mortgage obligations	49,357	8	(988)	48,377
Other securities	92,042	800	(2,619)	90,223
 Total debt securities	 325,209	 1,454	 (6,972)	 319,691
Marketable equity securities	22,330	3,494	(1,205)	24,619
 Total	 \$347,539	 \$4,948	 \$(8,177)	 \$344,310

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(In Thousands)	Amortized Cost	September 30, 2007		Fair Value
		Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	
HELD-TO-MATURITY SECURITIES:				
Obligations of the U.S. Treasury	\$ 308	\$ 9	\$	\$ 317
Obligations of other U.S. Government agencies	99	5		104
Mortgage-backed securities	3			3
Total	\$ 410	\$ 14	\$	\$ 424

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2007.

September 30, 2007 (In Thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AVAILABLE-FOR-SALE SECURITIES:						
Obligations of other U.S. Government agencies	\$ 1,497	\$ (3)	\$ 24,859	\$ (141)	\$ 26,356	\$ (144)
Obligations of states and political subdivisions	30,162	(1,875)	14,221	(488)	44,383	(2,363)
Mortgage-backed securities	14,218	(84)	37,700	(774)	51,918	(858)
Collateralized mortgage obligations	14,039	(40)	28,825	(948)	42,864	(988)
Other securities	27,520	(1,942)	28,799	(677)	56,319	(2,619)
Total debt securities	87,436	(3,944)	134,404	(3,028)	221,840	(6,972)
Marketable equity securities	7,971	(790)	1,899	(415)	9,870	(1,205)
Total temporarily impaired available-for-sale Securities	\$ 95,407	\$ (4,734)	\$ 136,303	\$ (3,443)	\$ 231,710	\$ (8,177)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

The unrealized losses on debt securities as of September 30, 2007 are primarily the result of volatility in interest rates. Based on the Corporation's ability and intent to hold the securities for the foreseeable future, and management's assessment of the credit worthiness of the issuers, management believes the Corporation's debt securities at September 30, 2007 were not other-than-temporarily impaired.

Unrealized losses on marketable equity securities are mainly from investments in common stocks of banking corporations. Management believes that recent declines in market prices of many bank stocks have been caused by media reports regarding sub-prime mortgage losses and similar events that have mainly affected mortgage banking operations and very large financial institutions. Accordingly, as of September 30, 2007, management believes the impairment of the Corporation's marketable equity securities to be temporary.

Table of Contents**CITIZENS & NORTHERN CORPORATION FORM 10-Q****5. DEFINED BENEFIT PLANS**

The Corporation has a noncontributory defined benefit pension plan for employees meeting certain age and length of service requirements. Benefits are based primarily on years of service and the average annual compensation during the highest five consecutive years.

On October 18, 2007, the Corporation's Board of Directors adopted amendments to the defined benefit pension plan to freeze and terminate the Plan, effective December 31, 2007. The Corporation expects that it would fund and settle its obligations under the Plan sometime in 2008. In connection with freezing and terminating the Plan, the Corporation has also amended the Plan to make lump sum distributions available to all active participants and vested former employees. The Corporation expects to record a gain or loss on curtailment of the Plan in the fourth quarter 2007, and a settlement gain or loss in 2008. The amount of curtailment gain or loss in 2007 and settlement gain or loss in 2008 has not yet been determined.

In addition, the Corporation sponsors a defined benefit health care plan that provides postretirement medical benefits and life insurance to employees who meet certain age and length of service requirements. This plan contains a cost-sharing feature, which causes participants to pay for all future increases in costs related to benefit coverage.

Accordingly, actuarial assumptions related to health care cost trend rates do not affect the liability balance at September 30, 2007 and December 31, 2006, and will not affect the Corporation's future expenses.

The Corporation uses a December 31 measurement date for its plans.

The components of net periodic benefit costs from these defined benefit plans are as follows:

(In Thousands)	Pension Benefits		Postretirement Benefits	
	Nine Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Service cost	\$ 512	\$ 457	\$ 55	\$ 48
Interest cost	525	472	52	46
Expected return on plan assets	(689)	(623)		
Amortization of transition (asset) obligation	(17)	(17)	27	27
Amortization of prior service cost	6	6		
Recognized net actuarial loss	34	53	2	2
Net periodic benefit cost	\$ 371	\$ 348	\$ 136	\$ 123

(In Thousands)	Pension		Postretirement	
	Three Months Ended		Three Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Service cost	\$ 170	\$ 152	\$ 18	\$ 16
Interest cost	175	157	17	15
Expected return on plan assets	(230)	(207)		
Amortization of transition (asset) obligation	(5)	(5)	9	9
Amortization of prior service cost	2	2		
Recognized net actuarial loss	11	18	1	1
Net periodic benefit cost	\$ 123	\$ 117	\$ 45	\$ 41

Due to freezing the defined benefit pension plan, management expects there will be no minimum required employer contribution to the defined benefit pension plan for 2007. Through the third quarter of 2007, the Corporation has

funded postretirement contributions totaling \$44,000, with estimated annual postretirement contributions, net of anticipated reimbursements from the Medicare (Part D) program, of \$33,000 expected in 2007 for the full year.

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As a result of the acquisition of Citizens Bancorp, Inc. (see Note 8), the Corporation assumed the Citizens Trust Company Retirement Plan, a defined benefit pension plan for which benefit accruals and participation were frozen in 2002. The Corporation used a September 30 measurement date for this plan in 2007, and will change to a December 31 measurement date in 2008. The Corporation's net periodic pension benefit recognized in the nine months ended September 30, 2007 was \$1,000.

6. STOCK-BASED COMPENSATION PLANS

In January 2007, the Corporation granted options to purchase a total of 43,385 shares of common stock through its Stock Incentive and Independent Directors Stock Incentive Plans. The exercise price for these options is \$22.325 per share, which was the market price as of the date of grant. The Corporation neither modified, nor issued, any new options in 2006.

SFAS No. 123R requires the Corporation to record stock option expense based on estimated fair value calculated using an option valuation model. The fair value of each option granted in 2007 was estimated to be \$4.46 per share as of the grant date. In calculating the fair value, the Corporation utilized the Black-Scholes option-pricing model with the following assumptions:

Volatility 23%

Expected option lives 8 years

Risk-free interest rate 4.69%

Dividend yield 3.61%

In calculating the estimated fair value of the 2007 stock option awards, the Corporation utilized its historical volatility and dividend yield over the immediately prior 8-year period to estimate future levels of volatility and dividend yield. The risk-free interest rate was based on the published yield of zero-coupon U.S. Treasury strips with an 8-year maturity as of the grant dates. The 8-year term was based on management's estimate of the average term for all options issued under both plans.

In calculating stock option expense for the 2007 stock option awards, management assumed a 23% forfeiture rate for options granted under the Stock Incentive Plan, and a 0% forfeiture rate for the Directors Stock Incentive Plan. These estimated forfeiture rates were determined based on the Corporation's historical experience.

Also, effective in January 2007, the Corporation awarded a total of 5,835 shares of restricted stock under the Stock Incentive and Independent Directors Stock Incentive Plans. Compensation cost related to restricted stock is recognized based on the market price of the stock at the grant date over the vesting period.

Total stock-based compensation expense is as follows:

(In Thousands)	3 Months Ended		Fiscal Year To Date	
	Sept. 30, 2007	Sept. 30, 2006	9 Months Ended Sept. 30, 2007	2006
	(Current)	(Prior Year)	(Current)	(Prior Year)
Stock options	\$	\$	\$ 156	\$
Restricted stock	25	9	75	29
Total	\$25	\$ 9	\$ 231	\$ 29

Stock option expense has been recognized over the six-month vesting period for the 2007 awards.

7. CONTINGENCIES

In the normal course of business, the Corporation may be subject to pending and threatened lawsuits in which claims for monetary damages could be asserted. In management's opinion, the Corporation's financial position and results of operations would not be materially affected by the outcome of such pending legal proceedings.

Table of Contents**CITIZENS & NORTHERN CORPORATION FORM 10-Q****8. MERGER**

On May 1, 2007, the Corporation completed its acquisition of 100% of the outstanding voting stock of Citizens Bancorp, Inc. (Citizens.) Accordingly, the results of operations for the former Citizens have been included in the accompanying consolidated financial statements from that date forward. In connection with the transaction, Citizens Trust Company, the banking subsidiary of Citizens, has merged with and into Citizens & Northern Bank (C&N Bank), a subsidiary of the Corporation. The Corporation's management believes the acquisition of Citizens provides two significant benefits: (1) extension of its geographic market for banking services, which should provide growth opportunities, and (2) addition of management personnel with background and skills complementary to the Corporation's management personnel.

The aggregate acquisition price was \$28,391,000, which included cash of \$14,323,000 and 636,967 shares of the Corporation's common stock valued at \$14,068,000. The value of the stock issued was determined based on the average market price of the shares over the seven days before and after the date the terms of the acquisition agreement were negotiated and publicly announced, adjusted for the values of Citizens shares held prior to the merger announcement and Corporation shares that were held by Citizens.

The Corporation is in the process of obtaining final valuations on loans, intangible assets, premises and equipment, deposits and other liabilities; accordingly, allocation of the purchase price is subject to modification in the future. Information regarding the purchase price and estimated fair values of assets acquired and liabilities assumed as of the acquisition date is provided as supplemental information in the consolidated statement of cash flows. Following are pro forma income statement amounts, without adjustment for the material nonrecurring items described below, assuming the acquisition was made on January 1, 2006:

(In Thousands)	3 Months Ended		Fiscal Year To Date	
	Sept. 30, 2007 (Current)	Sept. 30, 2006 (Prior Year)	9 Months Ended Sept. 30, 2007 (Current)	Sept. 30, 2006 (Prior Year)
Net interest income	\$9,507	\$9,337	\$28,124	\$28,280
Net income	\$2,848	\$3,632	\$6,790	\$10,238
Net income per share basic	\$0.32	\$0.41	\$0.76	\$1.14
Net income per share diluted	\$0.32	\$0.40	\$0.76	\$1.14

Citizens recorded material, nonrecurring expenses and losses which reduced pro forma net income (included in the table immediately above) by \$698,000 for the nine months ended September 30, 2007. These nonrecurring items included merger-related professional expense and realized losses from sales of securities. Excluding the effect of these nonrecurring items, pro forma income statement amounts (assuming the acquisition was made on January 1, 2006) are as follows:

(In Thousands)	3 Months Ended		Fiscal Year To Date	
	Sept. 30, 2007 (Current)	Sept. 30, 2006 (Prior Year)	9 Months Ended Sept. 30, 2007 (Current)	Sept. 30, 2006 (Prior Year)
Net income	\$2,848	\$3,632	\$7,488	\$10,238
Net income per share basic	\$0.32	\$0.41	\$0.84	\$1.14

Net income per share	diluted	\$ 0.32	\$ 0.40	\$ 0.84	\$ 1.14
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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements in this section and elsewhere in this quarterly report on Form 10-Q are forward-looking statements. Citizens & Northern Corporation and its wholly-owned subsidiaries intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995. Forward-looking statements, which are not historical facts, are based on certain assumptions and describe future plans, business objectives and expectations, and are generally identifiable by the use of words such as, "should", "likely", "expect", "plan", "anticipate", "target", "forecast", and "goal". These forward-looking statements are subject to uncertainties that are difficult to predict, may be beyond management's control and could cause results to differ materially from those expressed or implied by such forward-looking statements. Factors which could have a material, adverse impact on the operations and future prospects of the Corporation include, but are not limited to, the following:

- changes in monetary and fiscal policies of the Federal Reserve Board and the U. S. Government, particularly related to changes in interest rates

- changes in general economic conditions

- legislative or regulatory changes

- downturn in demand for loan, deposit and other financial services in the Corporation's market area

- increased competition from other banks and non-bank providers of financial services

- technological changes and increased technology-related costs

- changes in accounting principles, or the application of generally accepted accounting principles.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

REFERENCES TO 2007 AND 2006

Unless otherwise noted, all references to 2007 in the following discussion of operating results are intended to mean the nine months ended September 30, 2007, and similarly, references to 2006 relate to the nine months ended September 30, 2006.

EARNINGS OVERVIEW

Net Income was \$7,242,000 in the first nine months of 2007, down 22.1% from the first nine months of 2006. Net Income Per Share was \$0.84 (basic and diluted) in the first nine months of 2007, down 24.3% from Net Income Per Share of \$1.11 (basic and diluted) in the first nine months of 2006. Return on average assets was 0.83% in the first nine months of 2007 and 1.09% in the first nine months of 2006. Return on average equity was 7.02% in the nine months ended September 30, 2007 and 9.45% in the nine months ended September 30, 2006. Cash dividends declared were \$0.72 per share in both 2007 and 2006.

Earnings for the first nine months of 2007 were impacted by a loss (net of tax) on mortgage-backed securities of \$1,352,000. These securities were classified as other-than-temporarily impaired in the second quarter 2007, and written down through earnings by \$1,175,000, net of tax. The securities were sold in July 2007, with a further loss of \$177,000 (net of tax) realized in the third quarter. The impact per share of the loss from these securities, excluding the positive effect of investing the sale proceeds at higher yields, was \$0.16 (basic and diluted) for the first nine months of 2007.

On May 1, 2007, the acquisition of Citizens Bancorp, Inc. became effective. Citizens Bancorp, Inc. was the parent company of Citizens Trust Company, with offices in Coudersport, Port Allegany and Emporium, PA. The Citizens

Trust Company operations, which are now part of Citizens & Northern Bank, contributed significantly to growth in total assets, including loans, as well as the growth in deposits and trust assets under management, and increases in revenues and expenses in 2007.

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Significant income statement changes between 2007 and 2006 were as follows:

Net interest margin increased \$1,441,000, or 5.7%, in 2007 as compared to 2006. Most of the increase in the net interest margin between years occurred in the third quarter, since the net interest margin for the third quarter 2007 was \$1,188,000 higher than for the third quarter 2006. Factors contributing to recent improvements in the net interest margin include: (1) the acquisition of Citizens Trust Company, which resulted in increased interest and fees on loans, and provided funding to help pay off borrowings, (2) a change in the shape of the yield curve, which has become slightly positive after remaining flat or inverted throughout 2006 and the first half of 2007, allowing the Corporation a few opportunities to earn a positive spread from borrowing and investing activities, and (3) the increase in yield on the investment portfolio resulting from the restructuring described above.

Noninterest revenue increased \$1,684,000 (28.4%) in 2007 over 2006. Trust and Financial Management revenue increased \$722,000 (40.5%). Other significant increases in noninterest revenue included: service charges on deposits, which increased \$301,000, increases of \$197,000 for service charges and fees, including letter of credit and ATM-related fees, as well as increases of \$415,000 in other operating income, which includes debit card fees, credit card (as a third party agent), a gain from sale of a restricted stock, and certain training grant revenues.

Net realized losses (pre-tax) from sales of securities amounted to \$79,000 in 2007, as compared to pre-tax securities gains of \$4,250,000 in 2006. Excluding the \$2,048,000 pre-tax loss on impaired securities described above, securities gains for 2007, totaled \$1,969,000, down \$2,281,000 from 2006. Most of the gains realized in both periods were from sales of bank stocks.

Noninterest expense increased \$1,668,000 (7.1%) in 2007 as compared to 2006. The increase in expenses reflects the addition of Citizens Trust Company. Also, professional fees of \$221,000 have been incurred in 2007 related to the computer core system conversions of the First State Bank (New York) and Citizens Trust Company operations.

The income tax provision decreased \$560,000, to \$1,695,000 in 2007 from \$2,255,000 in 2006, as a result of lower pre-tax earnings.

Third Quarter 2007

Net Income in the third quarter 2007 was \$2,848,000, down \$425,000 (13.0%) from the third quarter 2006, and \$912,000 (47.1%) higher than second quarter 2007. Net Income Per Share (basic and diluted) was \$0.32 in the third quarter 2007, as compared to \$0.39 (basic and diluted) in the third quarter 2006, and \$0.22 (basic and diluted) in the second quarter 2007. Net realized losses (pre-tax) from sales of securities amounted to \$68,000 in the third quarter 2007, as compared to pre-tax securities gains of \$1,602,000 in the third quarter 2006. Third quarter 2007 earnings were positively affected by improvements in the net interest margin and increases in noninterest revenue, as referred to in the discussion of year-to-date results above. In addition to securities losses, third quarter earnings were negatively affected by one time costs totaling \$427,000, including professional fees associated with computer core system conversions and a loss on the disposition of telephone equipment.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE I QUARTERLY FINANCIAL DATA
(In Thousands)

	Sept. 30, 2007	June 30, 2007	Mar. 31, 2007	Dec. 31, 2006	Sept. 30, 2006	June 30, 2006	Mar. 31, 2006
Interest income	\$ 18,058	\$ 17,692	\$ 16,243	\$ 16,463	\$ 16,152	\$ 15,984	\$ 15,863
Interest expense	8,551	8,679	8,000	8,097	7,833	7,566	7,278
Interest margin	9,507	9,013	8,243	8,366	8,319	8,418	8,585
Provision for loan losses			229	181	191	(300)	600
Interest margin after provision for loan losses	9,507	9,013	8,014	8,185	8,128	8,718	7,985
Other income	2,877	2,644	2,088	2,045	2,199	1,937	1,789
Net (losses) gains on available-for-sale securities	(68)	(1,172)	1,161	796	1,602	1,333	1,315
Gain from sale of credit card loans				340			
Other expenses	8,691	8,189	8,247	8,155	7,640	7,976	7,843
Income before income tax provision	3,625	2,296	3,016	3,211	4,289	4,012	3,246
Income tax provision	777	360	558	517	1,016	813	426
Net income	\$ 2,848	\$ 1,936	\$ 2,458	\$ 2,694	\$ 3,273	\$ 3,199	\$ 2,820
Net income per share basic	\$ 0.32	\$ 0.22	\$ 0.30	\$ 0.32	\$ 0.39	\$ 0.38	\$ 0.34
Net income per share diluted	\$ 0.32	\$ 0.22	\$ 0.30	\$ 0.32	\$ 0.39	\$ 0.38	\$ 0.33

The number of shares used in calculating net income per share for each quarter presented in Table I reflects the retroactive effect of stock dividends.

Prospects for the Fourth Quarter 2007

Management has begun several initiatives designed to increase revenues and reduce expenses over the remainder of 2007 and in 2008. Management expects some of the initiatives to immediately increase revenues or decrease expenses, while other changes may result in an up front cost or expense, followed by future improvements. As part of these initiatives, full-time equivalent staffing is being reduced approximately 10% during the last half of 2007. Looking beyond the end of 2007, management expects that expansion of the Corporation's footprint including in 2005 through 2007 the construction or acquisition of banking facilities in Lycoming County, PA, New York State (First State Bank) and most recently, the Citizens Trust Company locations will produce opportunities to increase profitability by increasing loans, deposits and Trust and Financial Management volume.

As referred to in Note 5 to the financial statements, in October 2007 the Corporation's Board of Directors adopted amendments to the defined benefit pension plan to freeze and terminate the Plan, effective December 31, 2007. The purpose of freezing and terminating the Plan is to control and reduce future employee benefit expenses. Management expects to present an amendment to the Corporation's Employee Savings & Retirement Plan (a 401(k) plan), for Board

approval, which would increase employer matching contributions under that plan in 2008. Based on the current number and composition of employees and 401(k) plan participation, the increase in expense in 2008 associated with the 401(k) Plan will be approximately \$150,000, which is less than the ongoing expense (\$495,000 for the year ending December 31, 2007) that would be expected from maintaining the defined benefit pension plan. The Corporation expects to record a gain or loss on curtailment of the Plan in the fourth quarter 2007, and a settlement gain or loss in 2008. The amount of curtailment gain or loss in 2007 and settlement gain or loss in 2008 has not yet been determined. A major variable that affects the Corporation's earnings is securities gains and losses, particularly from bank stocks and other equity securities. Management's decisions regarding sales of securities are based on a variety of factors, with the overall goal of maximizing portfolio return over a long-term horizon. It is difficult to predict, with much precision, the amount of net securities gains and losses that will be realized in the fourth quarter 2007.

Table of Contents**CITIZENS & NORTHERN CORPORATION FORM 10-Q
CRITICAL ACCOUNTING POLICIES**

The presentation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

A material estimate that is particularly susceptible to significant change is the determination of the allowance for loan losses. Management believes that the allowance for loan losses is adequate and reasonable. The Corporation's methodology for determining the allowance for loan losses is described in a separate section later in Management's Discussion and Analysis. Given the very subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions, and could, therefore, calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Corporation's debt securities. The Corporation receives estimated fair values of debt securities from an independent valuation service, or from brokers. In developing these fair values, the valuation service and the brokers use estimates of cash flows, based on historical performance of similar instruments in similar interest rate environments. Based on experience, management is aware that estimated fair values of debt securities tend to vary among brokers and other valuation services. Accordingly, when selling debt securities, management typically obtains price quotes from more than one source. The large majority of the Corporation's securities are classified as available-for-sale. Accordingly, these securities are carried at fair value on the consolidated balance sheet, with unrealized gains and losses excluded from earnings and reported separately through accumulated other comprehensive income (included in stockholders' equity).

NET INTEREST MARGIN

The Corporation's primary source of operating income is represented by the net interest margin. The net interest margin is equal to the difference between the amounts of interest income and interest expense. Tables II, III and IV include information regarding the Corporation's net interest margin for 2007 and 2006. In each of these tables, the amounts of interest income earned on tax-exempt securities and loans have been adjusted to a fully taxable-equivalent basis. Accordingly, the net interest margin amounts reflected in these tables exceed the amounts presented in the consolidated financial statements. The discussion that follows is based on amounts in the related Tables.

The fully taxable equivalent net interest margin was \$28,193,000 in 2007, \$995,000 (3.7%) higher than in 2006. As shown in Table IV, net increases in volume had the effect of increasing net interest income \$1,152,000 in 2007 over 2006 while interest rate changes had the effect of decreasing net interest income \$157,000. Increases in volume of earning assets and interest-bearing liabilities were significantly affected by the acquisition of Citizens Trust Company on May 1, 2007. The most significant components of the volume changes in 2007 were an increase of \$3,475,000 attributable to loan growth and a decrease in interest expense on short-term and long-term borrowings of \$991,000, partially offset by lower interest income of \$2,031,000 from available-for-sale securities and an increase in interest expense of \$880,000 on certificates of deposit. As presented in Table III, the Interest Rate Spread (excess of average rate of return on interest-bearing assets over average cost of funds on interest-bearing liabilities) was 2.89% in the first nine months of 2007, as compared to 2.90% for the year ended December 31, 2006 and 2.93% in the first nine months of 2006.

Table of Contents**CITIZENS & NORTHERN CORPORATION FORM 10-Q****INTEREST INCOME AND EARNING ASSETS**

Interest income totaled \$53,423,000 in 2007, an increase of 7.1% over 2006. Interest and fees from loans increased \$5,131,000, or 15.4%, while income from available-for-sale securities decreased \$1,623,000, or 10.0%. As indicated in Table III, total average available-for-sale securities in 2007 fell to \$347,617,000, a decrease of \$44,125,000 or 11.3% from 2006. Throughout the calendar year 2006 and the first nine months of 2007, proceeds from sales and maturities of securities were used, in part, to help fund loans and pay off borrowings. Within the available-for-sale securities portfolio, the average balance of municipal bonds shrunk by \$32,566,000 in 2007 as compared to 2006. Management decided in mid-2006 to reduce the Corporation's investment in municipal bonds in order to reduce the alternative minimum tax liability. The average rate of return on available-for-sale securities was 5.62% for 2007, in line with the 5.55% return for the year ended December 31, 2006 and 5.55% in the first nine months of 2006. The average balance of gross loans increased 10.1% to \$723,794,000 in 2007 from \$657,447,000 in the first nine months of 2006. Excluding Citizens Trust Company, average loans increased 1.0% despite the payoff of \$22,475,000 associated with one significant commercial relationship. The Corporation has experienced an increase in average balances of both residential mortgage and commercial loans in 2007. The average rate of return on loans was 7.10% in 2007, up from 6.81% for the year ended December 31, 2006 and 6.77% in the first nine months of 2006.

INTEREST EXPENSE AND INTEREST-BEARING LIABILITIES

Interest expense rose \$2,553,000, or 11.3%, to \$25,230,000 in 2007 from \$22,677,000 in 2006. Table III shows that the overall cost of funds on interest-bearing liabilities rose to 3.72% in 2007, from 3.44% for the year ended December 31, 2006 and 3.38% in the first nine months of 2006.

From Table III, you can calculate that total average deposits (interest-bearing and noninterest-bearing) increased 7.5%, to \$809,001,000 in 2007 from \$752,575,000 in the first nine months of 2006. In July 2007, the Citizens Trust Company operations were converted to the same operational platform as Citizens & Northern Bank, and \$13,343,000 of money market deposits was transferred to another financial institution. Management utilizes a third-party provider for Trust & Financial Management money market allocations primarily for interest rate risk management reasons. Excluding acquired Citizens Trust Company deposit accounts, net of the transfers above, total average deposits increased 0.7%. The average rate incurred on certificates of deposit has increased significantly in 2007 over the first half of 2006, to 4.46% from 3.87%. Also, the average rate on Individual Retirement Accounts increased significantly, to 4.54% in 2007 from 4.18% in the first nine months of 2006.

The combined average total short-term and long-term borrowed funds decreased \$34,534,000 to \$211,535,000 in 2007 from \$246,069,000 in the first nine months of 2006. With the yield curve being flat or inverted throughout 2006 and the first half of 2007, opportunities have been limited for earning a positive spread by purchasing or holding investment securities as compared to interest costs associated with maintaining borrowed funds. Accordingly, the Corporation paid off many borrowings as they matured. The average rate on long-term borrowings was 4.11% in 2007, up from 3.53% in the first nine months of 2006.

Table of Contents**CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE II ANALYSIS OF INTEREST INCOME AND EXPENSE**

(In Thousands)	Nine Months Ended September 30,		Increase/ (Decrease)
	2007	2006	
INTEREST INCOME			
Available-for-sale securities:			
Taxable	\$11,618	\$11,633	\$ (15)
Tax-exempt	3,006	4,614	(1,608)
Total available-for-sale securities	14,624	16,247	(1,623)
Held-to-maturity securities, Taxable	18	18	
Trading securities	66		66
Interest-bearing due from banks	74	58	16
Federal funds sold	200	242	(42)
Loans:			
Taxable	36,889	31,907	4,982
Tax-exempt	1,552	1,403	149
Total loans	38,441	33,310	5,131
Total Interest Income	53,423	49,875	3,548
INTEREST EXPENSE			
Interest checking	1,485	1,378	107
Money market	4,535	4,340	195
Savings	256	257	(1)
Certificates of deposit	8,085	6,187	1,898
Individual Retirement Accounts	4,413	3,827	586
Other time deposits	6	6	
Short-term borrowings	1,397	1,611	(214)
Long-term borrowings	5,053	5,071	(18)
Total Interest Expense	25,230	22,677	2,553
Net Interest Income	\$28,193	\$27,198	\$ 995

Note: Interest income from tax-exempt securities and loans has been adjusted to a fully tax-equivalent basis, using the Corporation's marginal federal income tax rate of 34%.

Table of Contents**CITIZENS & NORTHERN CORPORATION FORM 10-Q****Table III Analysis of Average Daily Balances and Rates****(Dollars in Thousands)**

	9 Months Ended 9/30/2007 Average Balance	Rate of Return/ Cost of Funds %	Year Ended 12/31/2006 Average Balance	Rate of Return/ Cost of Funds %	9 Months Ended 9/30/2006 Average Balance	Rate of Return/ Cost of Funds %
EARNING ASSETS						
Available-for-sale securities, at amortized cost:						
Taxable	\$ 285,215	5.45%	\$ 295,138	5.25%	\$ 296,774	5.24%
Tax-exempt	62,402	6.44%	89,981	6.51%	94,968	6.50%
Total available-for-sale securities	347,617	5.62%	385,119	5.55%	391,742	5.55%
Held-to-maturity securities,						
Taxable	412	5.84%	418	5.74%	419	5.74%
Trading securities	1,541	5.73%		0.00%		0.00%
Interest-bearing due from banks	2,058	4.81%	2,272	4.01%	2,066	3.75%
Federal funds sold	5,091	5.25%	4,580	5.48%	5,763	5.61%
Loans:						
Taxable	691,194	7.14%	631,969	6.84%	627,102	6.80%
Tax-exempt	32,600	6.37%	30,745	6.19%	30,345	6.18%
Total loans	723,794	7.10%	662,714	6.81%	657,447	6.77%
Total Earning Assets	1,080,513	6.61%	1,055,103	6.34%	1,057,437	6.31%
Cash	19,488		19,027		19,309	
Unrealized gain/loss on securities	553		3,151		3,385	
Allowance for loan losses	(8,662)		(8,495)		(8,589)	
Bank premises and equipment	26,337		23,491		23,517	
Intangible Asset Core						
Deposit Intangible	1,239		389		402	
Intangible Asset Goodwill	7,810		2,912		2,919	
Other assets	40,462		39,111		39,165	
Total Assets	\$1,167,740		\$1,134,689		\$1,137,545	
INTEREST-BEARING LIABILITIES						

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Interest checking	\$ 75,576	2.63%	\$ 68,369	2.61%	\$ 70,275	2.62%
Money market	183,798	3.30%	179,288	3.24%	180,001	3.22%
Savings	62,702	0.55%	62,030	0.54%	63,072	0.54%
Certificates of deposit	242,189	4.46%	215,460	3.96%	213,792	3.87%
Individual Retirement						
Accounts	130,099	4.54%	122,459	4.28%	122,491	4.18%
Other time deposits	1,467	0.55%	1,116	0.63%	1,256	0.64%
Short-term borrowings	47,266	3.95%	56,606	4.09%	54,275	3.97%
Long-term borrowings	164,269	4.11%	188,077	3.59%	191,794	3.53%
Total Interest-bearing						
Liabilities	907,366	3.72%	893,405	3.44%	896,956	3.38%
Demand deposits	113,170		102,260		101,688	
Other liabilities	9,697		7,942		7,806	
Total Liabilities	1,030,233		1,003,607		1,006,450	
Stockholders equity,						
excluding other						
comprehensive income/loss	138,299		129,004		128,856	
Other comprehensive						
income/loss	(792)		2,078		2,239	
Total Stockholders Equity	137,507		131,082		131,095	
Total Liabilities and						
Stockholders Equity	\$ 1,167,740		\$ 1,134,689		\$ 1,137,545	
Interest Rate Spread		2.89%		2.90%		2.93%
Net Interest						
Income/Earning Assets		3.49%		3.42%		3.44%

(1) Rates of return on tax-exempt securities and loans are presented on a fully taxable-equivalent basis.

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

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE IV ANALYSIS OF VOLUME AND RATE CHANGES
(In Thousands)

	YTD Ended 9/30/07 vs. 9/30/06		
	Change in Volume	Change in Rate	Total Change
EARNING ASSETS			
Available-for-sale securities:			
Taxable	\$ (462)	\$ 447	\$ (15)
Tax-exempt	(1,569)	(39)	(1,608)
Total available-for-sale securities	(2,031)	408	(1,623)
Held-to-maturity securities, Taxable			
Trading securities	66		66
Interest-bearing due from banks		16	16
Federal funds sold	(27)	(15)	(42)
Loans:			
Taxable	3,369	1,613	4,982
Tax-exempt	106	43	149
Total loans	3,475	1,656	5,131
Total Interest Income	1,483	2,065	3,548
INTEREST-BEARING LIABILITIES			
Interest checking	104	3	107
Money market	93	102	195
Savings	(2)	1	(1)
Certificates of deposit	880	1,018	1,898
Individual Retirement Accounts	246	340	586
Other time deposits	1	(1)	
Short-term borrowings	(207)	(7)	(214)
Long-term borrowings	(784)	766	(18)
Total Interest Expense	331	2,222	2,553
Net Interest Income	\$ 1,152	\$ (157)	\$ 995

(1) Changes in income on tax-exempt securities and loans are presented on a fully taxable-equivalent

basis, using the Corporation's marginal federal income tax rate of 34%.

- (2) The change in interest due to both volume and rates has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amount of the change in each.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE V COMPARISON OF NONINTEREST INCOME
(In Thousands)

	9 Months Ended	
	Sept. 30, 2007	Sept. 30, 2006
Trust and financial management revenue	\$2,506	\$ 1,784
Service charges on deposit accounts	1,824	1,523
Service charges and fees	501	304
Insurance commissions, fees and premiums	368	371
Increase in cash surrender value of life insurance	515	463
Other operating income	1,895	1,480
Total other operating income, before realized (losses) gains on securities, net	7,609	5,925
Realized (losses) gains on available-for-sale securities, net	(79)	4,250
Total Other Income	\$7,530	\$10,175

Securities gains and losses are discussed in the Earnings Overview section of Management's Discussion and Analysis. Excluding securities gains and losses, total noninterest income increased \$1,684,000 or 28.4%, in 2007 compared to 2006. Items of significance are as follows:

Trust and financial management revenue increased \$722,000 (40.5%), including an increase of 24.5% excluding Citizens Trust Company, and a contribution to revenue from Citizens Trust Company of \$285,000. Trust and financial management revenues are heavily affected by the amount of assets under management. Assets under management have increased 38.1% over the last 12 months, to \$682,428,000 at September 30, 2007. The increase in assets under management includes the impact of the addition of Citizens Trust Company, as well as significant appreciation in equity markets. Excluding Citizens Trust Company, assets under management increased 17.2% at September 30, 2007 compared to the same date in the previous year.

Service charges on deposit accounts increased \$301,000, or 19.7%, in 2007 as compared to 2006, including \$257,000 from Citizens Trust Company.

Service charges and fees increased \$197,000 in 2007 over 2006. Among the types of fees included in this category are letter of credit fees, which increased \$106,000 in 2007 because of a few large, commercial transactions, and ATM-related fees, which increased \$88,000 in 2007 over 2006.

Other operating income increased \$415,000, or 28.0%, in 2007 over 2006. Included in this category was an increase of \$60,000 in fees from credit card agent bank activities. In the first five months of 2006, the Corporation was in the final stages of processing transactions for the credit card portfolio that was sold in the fourth quarter 2005. Accordingly, costs associated with processing and exiting that activity, net of interchange and other fees, were charged against a liability that had been established in 2005 for the estimated remaining servicing cost. Since the Corporation no longer services credit card transactions, fees received in 2007 have been included in other operating income. Also included in this category were increases in interchange fees related to debit card transactions of \$92,000, increases in broker-dealer revenues of \$86,000, the gain on sale of a restricted equity security of \$80,000, as well as net losses on trading securities of \$24,000.

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TABLE VI COMPARISON OF NONINTEREST EXPENSE
(In Thousands)

	9 Months Ended	
	Sept. 30,	Sept. 30,
	2007	2006
Salaries and wages	\$10,769	\$10,111
Pensions and other employee benefits	3,190	3,151
Occupancy expense, net	1,954	1,680
Furniture and equipment expense	2,104	1,961
Pennsylvania shares tax	707	732
Other operating expense	6,403	5,824
Total Other Expense	\$25,127	\$23,459

Total noninterest expense increased \$1,668,000, or 7.1%, in 2007 over 2006. Significant items include:

Salaries and wages increased \$658,000, or 6.5%. Approximately \$524,000 of the increase is attributable to the addition of Citizens Trust Company. Also, this category includes an increase in stock-based compensation totaling \$164,000. As described in more detail in Note 6 to the consolidated financial statements, the Corporation made awards of stock options and restricted stock in 2007, but did not make any such awards in 2006. Stock option expense has been recognized over the six-month vesting period for the 2007 awards.

Total pensions and other employee benefits expense increased only \$39,000, or 1.2%. In 2007, the Corporation received a refund from its health insurance provider based on favorable claims experience from a prior year, and health insurance expense is \$225,000 lower in 2007 than 2006. Excluding health insurance, the cost of pensions and other employee benefits is 10.4% higher in 2007 than in 2006, including increases attributable to higher numbers of employees and other factors.

Occupancy expense increased \$274,000, or 16.3%. In March 2006, the administration building in Wellsboro and the Old Lycoming Township branch were opened. The increase in occupancy expense associated with operating those properties for 9 months in 2007, as opposed to 7 months in 2006, was \$146,000. Also, the acquisition of the Citizens Trust Company locations resulted in additional occupancy costs in 2007 of \$158,000.

Furniture and equipment expense increased \$143,000, or 7.3%, including \$156,000 attributed to Citizens Trust Company operations.

Other operating expense increased \$579,000, or 9.9%. This category includes many varieties of expenses, with significant increases and decreases in some of the individual expenses, as follows:

Increase of \$528,000 from the acquisition of Citizens Trust Company, including \$225,000 for amortization of the core deposit intangible, and excluding computer system conversion costs.

Increase of \$221,000 from professional and other fees associated with converting First State Bank and Citizens Trust Company locations to the same core computer system used by C&N Bank.

Increase of \$146,000 in cash-based Director fees, Director stock options and restricted stock.

Incurring \$145,000 in 2007 associated with a loss on the disposition of telephone equipment that was disposed in conjunction with efforts to provide improved, compatible communications at all locations.

Increase in miscellaneous taxes of \$46,000. Results for 2006 included a reduction in expense related to a sales tax refund.

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Increase in computer-related services of \$65,000, including services related to a new internet banking platform, branch deposit capture software and an employee time and attendance system.

Decrease in certain expense categories for which management has some discretion over spending, including a total reduction of \$293,000 in education and training, public relations and donations, office supplies and advertising.

Decrease in comparative 2007 expense because results for 2006 included a \$169,000 impairment write-down related to a leased building which management decided to vacate.

Decrease in expenses associated with Bucktail Life Insurance Company of \$62,000.

Decrease in expenses associated with other real estate properties of \$70,000.

FINANCIAL CONDITION

Significant changes in the average balances of the Corporation's earning assets and interest-bearing liabilities are described in the Net Interest Margin section of Management's Discussion and Analysis. The allowance for loan losses and stockholders' equity are discussed in separate sections of Management's Discussion and Analysis.

The Corporation's merger with Citizens Bancorp, Inc. closed on May 1, 2007. On the purchase date, loans increased approximately \$60 million, deposits increased approximately \$100 million and stockholders' equity increased approximately \$14 million. Also, intangible assets increased approximately \$11 million, and the net impact to the Corporation's balance sheet was a minor reduction in tangible assets as a percentage of tangible equity (tangible assets as a percentage of tangible equity was 10.73% at September 30, 2007 and 11.27% at December 31, 2006). Total capital purchases for 2007, excluding capital assets included in the Citizens Bancorp, Inc. acquisition, are estimated at approximately \$2.5 - \$3 million. In light of the Corporation's strong capital position and ample sources of liquidity, management does not expect the Citizens Bancorp, Inc. acquisition and other capital expenditures to have a material, detrimental effect on the Corporation's financial condition in 2007. Management believes the overall impact of the acquisition and capital purchases on the Corporation's earnings in 2007 and thereafter will depend on the Corporation's ability to build market share and produce profitable results from its investments in new locations, technology and other capital assets, and how long that will take.

Interest-bearing deposits increased approximately \$50 million since December 31, 2006. In addition to the impact on interest-bearing deposits of the Citizens Bancorp, Inc. merger (discussed earlier under Net Interest Margin), the Corporation's interest-bearing deposits at September 30, 2007 reflect a decrease of \$12.7 million in interest-bearing deposits for one significant municipal relationship. Deposit balances held under this relationship, which can fluctuate significantly from month-to-month, are approximately \$7.5 million below the year-to-date average balance under the relationship. In addition, management believes deposits have declined during 2007 because of investors' desire to move funds into appreciating equity markets.

PROVISION AND ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained at a level, which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectibility of the loan portfolio. In evaluating collectibility, management considers a number of factors, including the status of specific impaired loans, trends in historical loss experience, delinquency trends, credit concentrations, comparison of historical loan loss data to that of other financial institutions and economic conditions within the Corporation's market area. Allowances for impaired loans are determined based on collateral values or the present value of estimated cash flows. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries.

There are two major components of the allowance: (1) SFAS 114 allowances on larger loans, mainly commercial purpose, determined on a loan-by-loan basis; and (2) SFAS 5 allowances - estimates of losses incurred on the remainder of the portfolio, determined based on collective evaluation of impairment for various categories of loans.

SFAS 5 allowances include a portion based on historical net charge-off experience, and a portion based on evaluation of qualitative factors.

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Each quarter, management performs a detailed assessment of the allowance and provision for loan losses. A management committee called the Watch List Committee performs this assessment. Quarterly, the Watch List Committee and the applicable Lenders discuss each loan relationship under review, and reach a consensus on the appropriate SFAS 114 estimated loss amount for the quarter. The Watch List Committee's focus is on ensuring all pertinent facts are considered, and that the SFAS 114 loss amounts are reasonable. The assessment includes review of certain loans reported on the Watch List. All loans, which Lenders or the Credit Administration staff has assigned a risk rating of Special Mention, Substandard, Doubtful or Loss, are included in the Watch List. The scope of loans evaluated individually for impairment (SFAS 114 evaluation) include all relationships greater than \$200,000, for which there is at least one extension of credit graded Substandard, Doubtful or Loss. Also, relationships less than \$200,000 in the aggregate, but with an estimated loss of \$100,000 or more, are individually evaluated for impairment. The SFAS 5 component of the allowance includes estimates of losses incurred on loans that have not been individually evaluated for impairment. Management uses loan categories included in the Call Report (a quarterly report filed by FDIC-insured banks) to identify categories of loans with similar risk characteristics, and multiplies the loan balances for each category as of each quarter-end by two different factors to determine the SFAS 5 allowance amounts. These two factors are based on: (1) historical net charge-off experience, and (2) qualitative factors. The sum of the allowance amounts calculated for each risk category, including both the amount based on historical net charge-off experience and the amount based on evaluation of qualitative factors, is equal to the total SFAS 5 component of the allowance.

The historical net charge-off portion of the SFAS 5 allowance component is calculated by the Accounting Department as of the end of the applicable quarter. For each loan classification category used in the Call Report, the Accounting Department multiplies the outstanding balance as of the quarter-end (excluding loans individually evaluated for impairment) by the ratio of net charge-offs to average quarterly loan balances for the previous three calendar years. Prior to the fourth quarter 2005, C&N Bank had utilized the ratio of net charge-offs to average balances over a five-year period in calculating the historical loan loss experience portion of the allowance portfolio. Management made the change to the three-year assumption, which had very little effect on the allowance valuation as of December 31, 2005, mainly because management believes net charge-off experience over a 3-year period may be more representative of losses existing in the portfolio as of the balance sheet date.

Effective in the second quarter 2005, management began to calculate the effects of specific qualitative factors criteria to determine a percentage increase or decrease in the SFAS 5 allowance, in relation to the historical net charge-off percentage. The qualitative factors analysis involves assessment of changes in factors affecting the portfolio, to provide for estimated differences between losses currently inherent in the portfolio and the amounts determined based on recent historical loss rates and from identification of losses on specific individual loans. A management committee called the Qualitative Factors Committee meets quarterly, near the end of the final month of each quarter. The Qualitative Factors Committee discusses several qualitative factors, including economic conditions, lending policies, changes in the portfolio, risk profile of the portfolio, competition and regulatory requirements, and other factors, with consideration given to how the factors affect three distinct parts of the loan portfolio: Commercial, Mortgage and Consumer. During or soon after completion of the meeting, each member of the Committee prepares an update to his or her recommended percentage adjustment for each qualitative factor, and average qualitative factor adjustments are calculated for Commercial, Mortgage and Consumer loans. The Accounting Department multiplies the outstanding balance as of the quarter-end (excluding loans individually evaluated for impairment) by the applicable qualitative factor percentages, to determine the portion of the SFAS 5 allowance attributable to qualitative factors.

The allocation of the allowance for loan losses table (Table VIII) includes the SFAS 114 component of the allowance on the line item called Impaired Loans. SFAS 5 estimated losses, including both the portion determined based on historical net charge-off results, as well as the portion based on management's assessment of qualitative factors, are allocated in Table VIII to the applicable categories of commercial, consumer mortgage and consumer loans. In periods prior to 2005, the portion of the allowance determined by management's subjective assessment of economic conditions and other factors (which is now calculated using the qualitative factors criteria described above) was reflected completely in the unallocated component of the allowance. The unallocated portion of the allowance was \$189,000 at

September 30, 2007, up from \$24,000 at December 31, 2006, mainly because of reductions in the portion of the SFAS 5 allowances related to qualitative factors. In the first quarter 2007, the Qualitative Factors Committee decided to lower some of its estimated allowance percentages, mainly in categories related to monitoring the portfolio, based on perceived improvement in identifying and evaluating problem loan relationships on a timely basis. Only minor changes in qualitative factors impacted both the second and third quarters of 2007.

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The allowance for loan losses totaled \$8,709,000 at September 30, 2007, up from \$8,201,000 at December 31, 2006. As shown in Table VII, the allowance for loan losses recorded as a result of the Citizens Trust Company acquisition was \$587,000, which was based on Citizens Trust Company's SFAS 5 allowance at the time of acquisition. Table VII also shows that net charge-offs in 2007 were \$308,000, which is lower than historical levels over the past several years. Net charge-offs in the first six months of 2007 were substantially lower than net charge-offs in the comparable period of 2006. In the third quarter of 2007, net charge-offs increased to \$213,000 for the quarter, which is more comparable to recent historical levels. The provision for loan losses totaled \$229,000 in 2007, as compared to \$491,000 in the first nine months of 2006. In the second and third quarters of 2007, the Corporation had no provision for loan losses. The total amount of the provision for loan losses in each period is determined based on the amount required to maintain an appropriate allowance in light of all of the factors described above.

Table IX presents information related to past due and impaired loans. Total impaired loans amounted to \$5,345,000 at September 30, 2007, down from \$7,001,000 at June 30, 2007, \$7,943,000 at March 31, 2007 and \$8,011,000 at December 31, 2006. Nonaccrual loans totaled \$5,157,000 at September 30, 2007, down from \$6,807,000 at June 30, 2007, \$8,088,000 at March 31, 2007 and \$8,506,000 at December 31, 2006. The primary reduction in impaired and nonaccrual loans during 2007 resulted from the removal of loans for two unrelated commercial relationships from impaired and nonaccrual status during the second and third quarters. The SFAS 114 valuation allowance on impaired loans was \$1,796,000 at September 30, 2007, compared to \$1,734,000 at June 30, 2007, \$1,615,000 at March 31, 2007 and \$1,726,000 at December 31, 2006. For one commercial loan removed from nonaccrual status in the third quarter 2007, the Watch List Committee eliminated the valuation allowance that previously was \$300,000 at June 30, 2007. Also, the Watch List Committee decided to increase the valuation allowance on an impaired commercial loan to \$700,000 from \$400,000, based on an updated appraisal and the estimated costs required for sale of the related business, and established a valuation allowance of \$175,000 on another commercial loan that was determined to be impaired during the third quarter. Management believes it has been conservative in its decisions concerning identification of impaired loans, estimates of loss and nonaccrual status. However, the actual losses realized from these relationships could vary materially from the allowances calculated as of September 30, 2007. Management continues to closely monitor its commercial loan relationships for possible credit losses, and will adjust its estimates of loss and decisions concerning nonaccrual status, if appropriate.

Tables VII, VIII, IX and X present an analysis of the allowance for loan losses, the allocation of the allowance, information concerning impaired and past due loans and a five-year summary of loans by type.

TABLE VII ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES**(In Thousands)**

	9 Months Ended Sept. 30, 2007	9 Months Ended Sept. 30, 2006	2006	Years Ended December 31,			
				2005	2004	2003	2002
Balance, beginning of year	\$8,201	\$8,361	\$8,361	\$6,787	\$6,097	\$5,789	\$5,265
Charge-offs:							
Real estate loans	108	571	611	264	375	168	123
Installment loans	141	165	259	224	217	326	116
Credit cards and related plans	4	18	22	198	178	171	190
Commercial and other loans	123	183	200	298	16	303	123
Total charge-offs	376	937	1,092	984	786	968	552

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Recoveries:							
Real estate loans	6	6	27	14	3	75	30
Installment loans	27	44	65	61	32	52	30
Credit cards and related plans	8	21	25	30	23	17	18
Commercial and other loans	27	109	143	50	18	32	58
Total recoveries	68	180	260	155	76	176	136
Net charge-offs	308	757	832	829	710	792	416
Allowance for loan losses recorded in acquisition	587			377			
Provision for loan losses	229	491	672	2,026	1,400	1,100	940
Balance, end of year	\$8,709	\$8,095	\$8,201	\$8,361	\$6,787	\$6,097	\$5,789

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TABLE VIII ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES BY TYPE
(In Thousands)

	As of Sept. 30, 2007	2006	2005	As of December 31,			2002
				2004	2003		
Commercial	\$2,084	\$2,372	\$2,705	\$1,909	\$1,578		\$1,315
Consumer mortgage	3,989	3,556	2,806	513	456		460
Impaired loans	1,796	1,726	2,374	1,378	1,542		1,877
Consumer	651	523	476	409	404		378
Unallocated	189	24		2,578	2,117		1,759
Total Allowance	\$8,709	\$8,201	\$8,361	\$6,787	\$6,097		\$5,789

TABLE IX PAST DUE AND IMPAIRED LOANS
(In Thousands)

	As of Sept. 30, 2007	As of June 30, 2007	As of March 31, 2007	2006	As of December 31,			2002
					2005	2004	2003	
Impaired loans without a valuation allowance	\$1,567	\$1,690	\$2,578	\$2,674	\$ 910	\$3,552	\$ 114	\$ 675
Impaired loans with a valuation allowance	3,778	5,311	5,365	5,337	7,306	4,709	4,507	3,039
Total impaired loans	\$5,345	\$7,001	\$7,943	\$8,011	\$8,216	\$8,261	\$4,621	\$3,714
Valuation allowance related to impaired loans	\$1,796	\$1,734	\$1,615	\$1,726	\$2,374	\$1,378	\$1,542	\$1,877
Total nonaccrual loans	\$5,157	\$6,807	\$8,088	\$8,506	\$6,365	\$7,796	\$1,145	\$1,252
Total loans past due 90 days or more and still accruing	\$1,374	\$ 968	\$ 844	\$1,559	\$1,369	\$1,307	\$2,546	\$2,318

TABLE X SUMMARY OF LOANS BY TYPE
(In Thousands)

	Sept. 30, 2007	2006	2005	As of December 31,			2002
				2004	2003		

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Real estate construction	\$ 14,847	\$ 10,365	\$ 5,552	\$ 4,178	\$ 2,856	\$ 103
Real estate residential mortgage	442,959	387,410	361,857	347,705	330,807	292,136
Real estate commercial mortgage	142,484	178,260	153,661	128,073	100,240	78,317
Consumer	43,829	35,992	31,559	31,702	33,977	31,532
Agricultural	3,432	2,705	2,340	2,872	2,948	3,024
Commercial	48,905	39,135	69,396	43,566	34,967	30,874
Other	1,172	1,227	1,871	1,804	1,183	2,001
Political subdivisions	48,489	32,407	27,063	19,713	17,854	13,062
Lease receivables					65	96
Total	746,117	687,501	653,299	579,613	524,897	451,145
Less: allowance for loan losses	(8,709)	(8,201)	(8,361)	(6,787)	(6,097)	(5,789)
Loans, net	\$737,408	\$679,300	\$644,938	\$572,826	\$518,800	\$445,356

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DERIVATIVE FINANCIAL INSTRUMENTS**

The Corporation has utilized derivative financial instruments related to a certificate of deposit product called the Index Powered Certificate of Deposit (IPCD). IPCDs have a term of 5 years, with interest paid at maturity based on 90% of the appreciation (as defined) in the S&P 500 index. There is no guaranteed interest payable to a depositor of an IPCD however, assuming an IPCD is held to maturity, a depositor is guaranteed the return of his or her principal, at a minimum. In 2004, the Corporation stopped originating new IPCDs, but continues to maintain and account for IPCDs and the related derivative contracts entered into between 2001 and 2004.

Statement of Financial Accounting Standards No. 133 requires the Corporation to separate the amount received from each IPCD issued into 2 components: (1) an embedded derivative, and (2) the principal amount of each deposit.

Embedded derivatives are derived from the Corporation's obligation to pay each IPCD depositor a return based on appreciation in the S&P 500 index. Embedded derivatives are carried at fair value, and are included in other liabilities in the consolidated balance sheet. Changes in fair value of the embedded derivative are included in other expense in the consolidated income statement. The difference between the contractual amount of each IPCD issued, and the amount of the embedded derivative, is recorded as the initial deposit (included in interest-bearing deposits in the consolidated balance sheet). Interest expense is added to principal ratably over the term of each IPCD at an effective interest rate that will increase the principal balance to equal the contractual IPCD amount at maturity.

In connection with IPCD transactions, the Corporation has entered into Equity Indexed Call Option (Swap) contracts with the Federal Home Loan Bank of Pittsburgh (FHLB-Pittsburgh). Under the terms of the Swap contracts, the Corporation must pay FHLB-Pittsburgh quarterly amounts calculated based on the contractual amount of IPCDs issued times a negotiated rate. In return, FHLB-Pittsburgh is obligated to pay the Corporation, at the time of maturity of the IPCDs, an amount equal to 90% of the appreciation (as defined) in the S&P 500 index. If the S&P 500 index does not appreciate over the term of the related IPCDs, the FHLB-Pittsburgh would make no payment to the Corporation. The effect of the Swap contracts is to limit the Corporation's cost of IPCD funds to the market rate of interest paid to FHLB-Pittsburgh. (In addition, the Corporation paid a fee of 0.75% to a consulting firm at inception of each deposit. These fees are being amortized to interest expense over the term of the IPCDs.) Swap assets or liabilities are carried at fair value, and included in other assets or other liabilities in the consolidated balance sheet. Changes in fair value of swap liabilities are included in other expense in the consolidated income statement.

The impact to the income statement for 2007 and 2006 from IPCDs is not significant. Balance sheet amounts as of September 30, 2007 and December 31, 2006 related to IPCDs are as follows (in thousands):

	Sept. 30, 2007	Dec. 31, 2006
Contractual amount of IPCDs (equal to notional amount of Swap contracts)	\$1,098	\$2,516
Carrying value of IPCDs	1,069	2,444
Carrying value of embedded derivative liabilities	400	610
Carrying value of Swap contract (assets) liabilities	(366)	(528)

LIQUIDITY

Liquidity is the ability to quickly raise cash at a reasonable cost. An adequate liquidity position permits the Corporation to pay creditors, compensate for unforeseen deposit fluctuations and fund unexpected loan demand. The Corporation maintains overnight borrowing facilities with several correspondent banks that provide a source of day-to-day liquidity. Also, the Corporation maintains borrowing facilities with FHLB Pittsburgh, secured by mortgage loans and various investment securities. At September 30, 2007, the Corporation had unused borrowing availability with correspondent banks and the Federal Home Loan Bank of Pittsburgh totaling approximately \$236,000,000. Additionally, the Corporation uses repurchase agreements placed with brokers to borrow funds secured by investment assets, and uses RepoSweep arrangements to borrow funds from commercial banking customers on an overnight basis. Further, if required to raise cash in an emergency situation, the Corporation could sell non-pledged investment securities to meet its obligations. At September 30, 2007, the carrying value of non-pledged available-for-sale securities was \$107,971,000.

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Management believes the combination of its strong capital position (discussed in the next section), ample available borrowing facilities and substantial non-pledged securities portfolio have placed the Corporation in a position of minimal short-term and long-term liquidity risk.

STOCKHOLDERS EQUITY AND CAPITAL ADEQUACY

The Corporation and the subsidiary banks (Citizens & Northern Bank and First State Bank) are subject to various regulatory capital requirements administered by the federal banking agencies. The Corporation's estimated, consolidated capital ratios at September 30, 2007 are as follows:

Total capital to risk-weighted assets	16.87%
Tier 1 capital to risk-weighted assets	15.69%
Tier 1 capital to average total assets	11.00%

Management expects the Corporation and the subsidiary banks to maintain capital levels that exceed the regulatory standards for well-capitalized institutions for the next 12 months and for the foreseeable future. Planned capital expenditures are not expected to have a significantly detrimental effect on capital ratios.

The Corporation's total stockholders' equity is affected by fluctuations in the fair values of available-for-sale securities. The difference between amortized cost and fair value of available-for-sale securities, net of deferred income tax, is included in Accumulated Other Comprehensive Income within stockholders' equity. Changes in accumulated other comprehensive income are excluded from earnings and directly increase or decrease stockholders' equity.

The balance in accumulated other comprehensive income related to unrealized losses on available-for-sale securities, net of deferred income tax, amounted to a negative balance of \$2,130,000 at September 30, 2007, down from a positive balance resulting from net unrealized gains of \$1,794,000 at December 31, 2006. The decrease in accumulated other comprehensive income in 2007 resulted mainly from changes in interest rates, along with general pricing declines on trust preferred securities and bank stocks.

Effective December 31, 2006, the Corporation applied SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS No. 158 requires the Corporation to recognize the underfunded or overfunded status of defined benefit pension and postretirement plans as a liability or asset in the balance sheet. The Corporation has recognized a liability for the underfunded balance of its defined benefit pension and postretirement plans, and has recognized a reduction in stockholders' equity (included in accumulated other comprehensive income) for the amount of the liability, net of deferred income tax. Accumulated other comprehensive income included a negative balance of \$1