

NORWOOD FINANCIAL CORP
Form 10-Q
August 07, 2017

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 June 30, 2017

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

For the transition period from _____ to _____

Commission file number 0-28364

Norwood Financial Corp.
(Exact name of registrant as specified in its charter)

Pennsylvania 23-2828306
(State or other jurisdiction of (I.R.S. employer identification no.)
incorporation or organization)

717 Main Street, Honesdale, Pennsylvania 18431
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (570) 253-1455

N/A
Former name, former address and former fiscal year, if changed since last report.

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer,"

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"accelerated filer", "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of August 1, 2017
Common stock, par value \$0.10 per share	4,161,357

NORWOOD FINANCIAL CORP.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2017

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NORWOOD FINANCIAL CORP.

Consolidated Balance Sheets (unaudited)

(dollars in thousands, except share and per share data)

	June 30, 2017	December 31, 2016
ASSETS		
Cash and due from banks	\$16,055	\$14,900
Interest bearing deposits with banks	348	2,274
Cash and cash equivalents	16,403	17,174
Securities available for sale, at fair value	300,667	302,564
Loans receivable	735,026	713,889
Less: Allowance for loan losses	7,419	6,463
Net loans receivable	727,607	707,426
Regulatory stock, at cost	2,435	2,119
Bank premises and equipment, net	12,953	13,531
Bank owned life insurance	36,575	36,133
Accrued interest receivable	3,417	3,643
Foreclosed real estate owned	4,523	5,302
Goodwill	11,331	11,331
Other intangibles	531	612
Deferred tax asset	8,181	8,989
Other assets	2,690	2,359
TOTAL ASSETS	\$1,127,313	\$1,111,183
LIABILITIES		
Deposits:		
Non-interest bearing demand	\$200,364	\$191,445
Interest-bearing	732,107	733,940
Total deposits	932,471	925,385
Short-term borrowings	42,192	32,811
Other borrowings	25,330	32,001
Accrued interest payable	942	1,069
Other liabilities	10,211	8,838
TOTAL LIABILITIES	1,011,146	1,000,104
STOCKHOLDERS' EQUITY		
Common stock, \$.10 par value per share, authorized 10,000,000 shares; issued 4,164,723 shares	416	416
Surplus	47,645	47,682
Retained earnings	69,660	67,225
Treasury stock at cost: 2017: 566 shares, 2016: 4,509 shares	(22)	(125)
Accumulated other comprehensive loss	(1,532)	(4,119)

TOTAL STOCKHOLDERS' EQUITY	116,167	111,079
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,127,313	\$1,111,183

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Income (unaudited)
(dollars in thousand ds, except per share data)

	Three Months		Six Months Ended	
	Ended		June 30,	
	June 30,	2016	2017	2016
	2017			
INTEREST INCOME				
Loans receivable, including fees	\$7,925	\$6,351	\$15,731	\$12,485
Securities	1,633	878	3,251	1,768
Other	24	5	35	7
Total interest income	9,582	7,234	19,017	14,260
INTEREST EXPENSE				
Deposits	797	580	1,563	1,161
Short-term borrowings	28	37	56	77
Other borrowings	101	223	244	453
Total interest expense	926	840	1,863	1,691
NET INTEREST INCOME	8,656	6,394	17,154	12,569
PROVISION FOR LOAN LOSSES	600	700	1,200	1,150
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	8,056	5,694	15,954	11,419
OTHER INCOME				
Service charges and fees	1,016	604	1,951	1,178
Income from fiduciary activities	128	114	235	216
Net realized gains on sales of securities	31	205	37	270
Gains on sale of loans, net	67	18	67	47
Gain on sale of deposits	-	-	209	-
Earnings and proceeds on bank owned life insurance	275	166	530	333
Other	139	116	270	246
Total other income	1,656	1,223	3,299	2,290
OTHER EXPENSES				
Salaries and employee benefits	3,212	2,248	6,430	4,551
Occupancy, furniture & equipment, net	809	487	1,720	982
Data processing and related operations	324	255	668	526
Taxes, other than income	227	124	460	329
Professional fees	240	181	489	332
Federal Deposit Insurance Corporation insurance	91	117	186	231
Foreclosed real estate	152	432	724	462
Amortization of intangibles	39	23	80	47
Other	1,036	661	1,987	1,416
Total other expenses	6,130	4,528	12,744	8,876

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INCOME BEFORE INCOME TAXES	3,582	2,389	6,509	4,833
INCOME TAX EXPENSE	858	511	1,409	1,079
NET INCOME	\$2,724	\$1,878	\$5,100	\$3,754
BASIC EARNINGS PER SHARE	\$0.66	\$0.51	\$1.23	\$1.02
DILUTED EARNINGS PER SHARE	\$0.65	\$0.51	\$1.22	\$1.02

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.

Consolidated Statements of Comprehensive Income (unaudited)

(dollars in thousands)

	Three Months Ended June 30,	
	2017	2016
Net income	\$2,724	\$1,878
Other comprehensive income:		
Investment securities available for sale:		
Unrealized holding gain	2,735	1,810
Tax effect	(930)	(615)
Reclassification of gains recognized in net income	(31)	(205)
Tax effect	11	69
Other comprehensive income	1,785	1,059
Comprehensive Income	\$4,509	\$2,937

	Six Months Ended June 30,	
	2017	2016
Net income	\$5,100	\$3,754
Other comprehensive income:		
Investment securities available for sale:		
Unrealized holding gain	3,957	3,829
Tax effect	(1,346)	(1,301)
Reclassification of gains recognized in net income	(37)	(270)
Tax effect	13	92
Other comprehensive income	2,587	2,350
Comprehensive Income	\$7,687	\$6,104

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.

Consolidated Statements of Changes in Stockholders' Equity (unaudited)

Six Months Ended June 30, 2017

(dollars in thousands, except share and per share data)

	Common Stock		Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)		Total
	Shares	Amount		Surplus	Shares	Amount		
Balance, December 31, 2016	4,164,723	\$ 416	\$ 47,682	\$ 67,225	4,509	\$ (125)	\$ (4,119)	\$ 111,079
Net Income	-	-	-	5,100	-	-	-	5,100
Other comprehensive income	-	-	-	-	-	-	2,587	2,587
Cash dividends declared (\$.64 per share)	-	-	-	(2,665)	-	-	-	(2,665)
Compensation expense related to restricted stock	-	-	71	-	-	-	-	71
Acquisition of treasury stock	-	-	-	-	22,257	(854)	-	(854)
Stock options exercised	-	-	(263)	-	(26,200)	957	-	694
Tax benefit of stock options	-	-	109	-	-	-	-	109
Compensation expense related to stock options	-	-	46	-	-	-	-	46
Balance, June 30, 2017	4,164,723	\$ 416	\$ 47,645	\$ 69,660	566	\$ (22)	\$ (1,532)	\$ 116,167

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)

	Six Months Ended June 30,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$5,100	\$3,754
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,200	1,150
Depreciation	468	265
Amortization of intangible assets	80	47
Deferred income taxes	(525)	237
Net amortization of securities premiums and discounts	1,120	488
Net realized gain on sales of securities	(37)	(270)
Gain on sale of deposits	(209)	-
Earnings and proceeds on bank owned life insurance	(530)	(333)
Loss (gain) on sales and writedowns of fixed assets and foreclosed real estate owned	529	(46)
Gain on sale of loans	(67)	(54)
Loans originated for sale	(1,693)	(1,685)
Proceeds from sale of loans originated for sale	1,760	1,739
Compensation expense related to stock options	46	36
Compensation expense related to restricted stock	71	45
Decrease in accrued interest receivable	226	74
Decrease in accrued interest payable	(127)	(66)
Other, net	1,229	(872)
Net cash provided by operating activities	8,641	4,509
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available for sale:		
Proceeds from sales	1,835	31,776
Proceeds from maturities and principal reductions on mortgage-backed securities	14,792	7,544
Purchases	(11,893)	(26,848)
Purchase of regulatory stock	(1,378)	(1,679)
Redemption of regulatory stock	1,062	2,863
Net increase in loans	(21,481)	(26,846)
Purchase of premises and equipment	(155)	(121)
Proceeds from sales of fixed assets and foreclosed real estate owned	515	333
Net cash used in investing activities	(16,703)	(12,978)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	20,954	33,350
Deposits sold	(13,659)	-
Net increase (decrease) in short-term borrowings	9,381	(15,135)
Repayments of other borrowings	(16,671)	(4,547)
Proceeds from other borrowings	10,000	-
Stock options exercised	694	143
Tax benefit of stock options exercised	109	2

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Purchase of treasury stock	(854)	(447)
Cash dividends paid	(2,663)	(2,292)
Net cash provided by financing activities	7,291	11,074
(Decrease) increase in cash and cash equivalents	(771)	2,605
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	17,174	10,010
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$16,403	\$12,615

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NORWOOD FINANCIAL CORP.
 Consolidated Statements of Cash Flows (Unaudited) (continued)

(dollars in thousands)

	Six Months Ended June 30,	
	2017	2016
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest on deposits and borrowings	\$1,990	\$1,757
Income taxes paid, net of refunds	\$505	\$1,060
Supplemental Schedule of Noncash Investing Activities		
Transfers of loans to foreclosed real estate and repossession of other assets	\$71	\$2,879
Cash dividends declared	\$2,665	\$2,290

See accompanying notes to the unaudited consolidated financial statements.

Notes to the Unaudited Consolidated Financial Statements1. Basis of Presentation

The unaudited consolidated financial statements include the accounts of Norwood Financial Corp. (Company) and its wholly-owned subsidiary, Wayne Bank (Bank) and the Bank's wholly-owned subsidiaries, WCB Realty Corp., Norwood Investment Corp., Norwood Settlement Services, LLC, and WTRO Properties, Inc. On June 13, 2017, the Company approved and adopted a Plan of Dissolution for Norwood Settlement Services, LLC. All activity to date is included in the consolidated financial statements. All significant intercompany transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in conformity with generally accepted accounting principles for interim financial statements and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. The financial statements reflect, in the opinion of management, all normal, recurring adjustments necessary to present fairly the financial position and results of operations of the Company. The operating results for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017 or any other future interim period.

These statements should be read in conjunction with the consolidated financial statements and related notes which are incorporated by reference in the Company's Annual Report on Form 10-K for the year-ended December 31, 2016.

2. Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

The following table sets forth the weighted average shares outstanding used in the computations of basic and diluted earnings per share.

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Weighted average shares outstanding	4,160	3,691	4,161	3,696
Less: Unvested restricted shares	19	14	19	14
Basic EPS weighted average shares outstanding	4,141	3,677	4,142	3,682
Basic EPS weighted average shares outstanding	4,141	3,677	4,142	3,682

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Add: Dilutive effect of stock options	33	6	34	6
Diluted EPS weighted average shares outstanding	4,174	3,683	4,176	3,688

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As of June 30, 2017, there were no stock options that would be anti-dilutive to the earnings per share calculations based upon the closing price of Norwood common stock of \$42.25 per share on June 30, 2017.

At June 30, 2016, there were 58,300 anti-dilutive options based on Norwood's closing price of \$28.00 per share.

3. Stock-Based Compensation

No awards were granted during the six-month period ending June 30, 2017. As of June 30, 2017, there was \$46,000 of total unrecognized compensation cost related to non-vested options granted in 2016 under the 2014 Equity Incentive Plan, which will be fully amortized by December 31, 2017. Compensation costs related to stock options amounted to \$46,000 and \$36,000 during the six-month periods ended June 30, 2017 and 2016, respectively.

A summary of stock options from all plans, adjusted for stock dividends declared, is shown below.

	Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Yrs.	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2017	160,429	\$ 27.37	5.6	Yrs.	\$ 932
Granted	-	-	-		-
Exercised	(26,200)	26.47	3.6	Yrs.	694
Forfeited	(1,000)	28.55	8.5	Yrs.	29
Outstanding at June 30, 2017	133,229	\$ 27.54	5.4	Yrs.	\$ 1,912
Exercisable at June 30, 2017	117,229	\$ 26.72	4.8	Yrs.	\$ 1,778

Intrinsic value represents the amount by which the market price of the stock on the measurement date exceeded the exercise price of the option. The stock price was \$42.25 as of June 30, 2017 and \$33.14 as of December 31, 2016.

A summary of the Company's restricted stock activity for the six-month periods ended June 30, 2017 and 2016 is as follows:

	2017	Weighted-Average Grant Date Fair Value	2016	Weighted-Average Grant Date Fair Value
	Number of Restricted Stock		Number of Restricted Stock	
Non-vested, January 1,	18,690	\$ 30.96	13,810	\$ 28.82
Granted	-	-	-	-
Vested	-	-	-	-
Forfeited	-	-	-	-
Non-vested, June 30,	18,690	\$ 30.96	13,810	\$ 28.82

The expected future compensation expense relating to the 18,690 shares of non-vested restricted stock outstanding as of June 30, 2017 is \$507,000. This cost will be recognized over the remaining vesting period of 4.5 years. Compensation costs related to restricted stock amounted to \$71,000 and \$45,000 during the six-month periods ended June 30, 2017 and 2016, respectively.

4. Accumulated Other Comprehensive Income (Loss)

The following table presents the changes in accumulated other comprehensive income (loss) by component net of tax for the three months and six months ended June 30, 2017 and 2016:

(in thousands)

	Unrealized gains (losses) on available for sale securities (a)
Balance as of December 31, 2016	\$ (4,119)
Other comprehensive income before reclassification	2,611
Amount reclassified from accumulated other comprehensive income	(24)
Total other comprehensive income	2,587
Balance as of June 30, 2017	\$ (1,532)

	Unrealized gains (losses) on available for sale securities (a)
Balance as of December 31, 2015	\$ 488
Other comprehensive income before reclassification	2,528
Amount reclassified from accumulated other comprehensive income	(178)
Total other comprehensive income	2,350
Balance as of June 30, 2016	\$ 2,838

	Unrealized gains (losses) on available for sale securities (a)
Balance as of March 31, 2017	\$ (3,317)
Other comprehensive income before reclassification	1,805
Amount reclassified from accumulated other comprehensive income	(20)

Total other comprehensive income	1,785
Balance as of June 30, 2017	\$ (1,532)

	Unrealized gains (losses) on available for sale securities (a)
Balance as of March 31, 2016	\$ 1,779
Other comprehensive income before reclassification	1,195
Amount reclassified from accumulated other comprehensive income	(136)
Total other comprehensive income	1,059
Balance as of June 30, 2016	\$ 2,838

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

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The following table presents significant amounts reclassified out of each component of accumulated other comprehensive income (loss) (in thousands) for the three months and six months ended June 30, 2017 and 2016:

Details about other comprehensive income	Amount Reclassified From Accumulated Other Comprehensive Income (Loss) (a)	Affected Line Item in Consolidated Statements of Income
	Three months ended June 30, 2017	2016
Unrealized gains on available for sale securities	\$ 31	\$ 205
	(11)	(69)
	\$ 20	\$ 136
		Net realized gains on sales of securities Income tax expense
	Six months ended June 30, 2017	2016
Unrealized gains on available for sale securities	\$ 37	\$ 270
	(13)	(92)
	\$ 24	\$ 178
		Net realized gains on sales of securities Income tax expense

(a) Amounts in parentheses indicate debits to net income

5. Off-Balance Sheet Financial Instruments and Guarantees

The Bank 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 letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

A summary of the Bank's financial instrument commitments is as follows:

(in thousands)	June 30,	
	2017	2016
Commitments to grant loans	\$51,583	\$22,098
Unfunded commitments under lines of credit	69,171	49,358
Standby letters of credit	7,802	5,361
	\$128,556	\$76,817

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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer and generally consists of real estate.

The Bank does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Bank, generally, holds collateral and/or personal guarantees supporting these commitments. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of June 30, 2017 for guarantees under standby letters of credit issued is not material.

6. Securities

The amortized cost, gross unrealized gains and losses, and fair value of securities available for sale were as follows:

	June 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available for Sale:				
U.S. Treasury securities	\$ 2,003	\$ -	\$ (9)	\$ 1,994
States and political subdivisions	128,343	1,510	(1,215)	128,638
Corporate obligations	10,162	44	(92)	10,114
Mortgage-backed securities- government sponsored entities	162,670	37	(3,212)	159,495
Total debt securities	303,178	1,591	(4,528)	300,241
Equity securities-financial services	292	134	-	426
	\$ 303,470	\$ 1,725	\$ (4,528)	\$ 300,667

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In Thousands)				
Available for Sale:				
U.S. Treasury securities	\$2,005	\$ -	\$ (8	) \$1,997
States and political subdivisions	127,585	884	(3,368	) 125,101
Corporate obligations	10,255	37	(180	) 10,112
Mortgage-backed securities-government sponsored entities	169,124	26	(4,220	) 164,930
Total debt securities	308,969	947	(7,776	) 302,140
Equity securities-financial services	320	104	-	424
	\$309,289	\$ 1,051	\$ (7,776	) \$302,564

The following tables show the Company's investments' gross unrealized losses and fair value aggregated by length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	June 30, 2017					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	\$1,994	\$ (9	) \$-	\$ -	\$1,994	\$ (9
States and political subdivisions	78,120	(1,212	) 208	(3	) 78,328	(1,215
Corporate obligations	6,923	(92	) -	-	6,923	(92
Mortgage-backed securities-government sponsored entities	148,255	(2,973	) 9,071	(239	) 157,326	(3,212
	\$235,292	\$ (4,286	) \$9,279	\$ (242	) \$244,571	\$ (4,528

	December 31, 2016					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	\$1,997	\$ (8	) \$-	\$ -	\$1,997	\$ (8
States and political subdivisions	90,109	(3,362	) 205	(6	) 90,314	(3,368
Corporate obligations	6,895	(180	) -	-	6,895	(180
Mortgage-backed securities-government sponsored entities	152,614	(3,912	) 9,967	(308	) 162,581	(4,220
	\$251,615	\$ (7,462	) \$10,172	\$ (314	) \$261,787	\$ (7,776

At June 30, 2017, the Company has 215 debt securities in an unrealized loss position in the less than twelve months category and 12 debt securities in the twelve months or more category. In Management's opinion the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. No other-than-temporary-impairment charges were recorded in 2017. Management believes that all unrealized losses represent temporary impairment of the securities as the Company does not have the intent to sell the securities and it is more likely than not that it will not have to sell the securities before recovery of its cost basis.

The amortized cost and fair value of debt securities as of June 30, 2017 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	Available for Sale	
	Amortized Cost	Fair Value
	(In Thousands)	
Due in one year or less	\$4,192	\$4,205
Due after one year through five years	19,620	19,566
Due after five years through ten years	48,419	47,889
Due after ten years	68,277	69,086
Mortgage-backed securities-government sponsored agencies	162,670	159,495
	\$303,178	\$300,241

Gross realized gains and gross realized losses on sales of securities available for sale were as follows (in thousands):

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2017	2016	2017	2016
Gross realized gains	\$31	\$205	\$43	\$270
Gross realized losses	-	-	(6)	-
Net realized gain	\$31	\$205	\$37	\$270
Proceeds from sales of securities	\$1,831	\$16,492	\$1,835	\$31,776

Securities with a carrying value of \$226,759,000 and \$110,266,000 at June 30, 2017 and 2016, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase and for other purposes as required or permitted by law. The increase reflects pledging requirements resulting from the acquisition of Delaware Bancshares, Inc. ("Delaware").

7. Loans Receivable and Allowance for Loan Losses

Set forth below is selected data relating to the composition of the loan portfolio at the dates indicated (dollars in thousands):

	June 30, 2017	December 31, 2016
Real Estate Loans:		
Residential	\$ 234,251 31.9 %	\$ 237,177 33.2 %
Commercial	335,602 45.6	320,187 44.8
Construction	17,673 2.4	19,709 2.8
Commercial, financial and agricultural	84,502 11.5	85,508 12.0
Consumer loans to individuals	63,194 8.6	51,524 7.2
Total loans	735,222 100.0%	714,105 100.0%
Deferred fees, net	(196)	(216)
Total loans receivable	735,026	713,889
Allowance for loan losses	(7,419)	(6,463)
Net loans receivable	\$ 727,607	\$ 707,426

The following table presents the components of the purchase accounting adjustments related to the purchased credit-impaired loans acquired:

(In Thousands)	July 31, 2016
Contractually required principal and interest	\$ 2,621
Non-accretable discount	(1,014)
Expected cash flows	1,607
Accretable discount	(239)
Estimated fair value	\$ 1,368

Changes in the accretable yield for purchased credit-impaired loans were as follows for the six-month period ended June 30 (in thousands):

	2017
Balance at beginning of period	\$ 208
Additions	-
Accretion	(37)
Reclassification and other	-
Balance at end of period	\$ 171

The following table presents information regarding loans acquired and accounted for in accordance with ASC 310-30 (in thousands):

	June 30, 2017	December 31, 2016
Outstanding Balance	\$ 1,689	\$ 1,821
Carrying Amount	\$ 1,345	\$ 1,386

As a result of the acquisition of Delaware, the Company added \$1,397,000 of loans that were accounted for in accordance with ASC 310-30. Based on a review of the loans acquired by senior lending management, which included an analysis of credit deterioration of the loans since origination, the Company recorded a specific credit fair value adjustment of \$499,000. For loans that were acquired with specific evidence of deterioration in credit quality, loan losses will be accounted for through a reduction of the specific reserve and will not impact the allowance for loan losses until actual losses exceed the allotted reserves. For loans acquired without a deterioration of credit quality, losses incurred will result in adjustments to the allowance for loan losses through the allowance for loan loss adequacy calculation.

The Company maintains a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Impairment is measured on a loan-by-loan basis for commercial and construction loans by the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

Foreclosed assets acquired in settlement of loans are carried at fair value less estimated costs to sell and are included in foreclosed real estate owned on the Consolidated Balance Sheets. As of June 30, 2017 and December 31, 2016, foreclosed real estate owned totaled \$4,523,000 and \$5,302,000, respectively. During the six months ended June 30, 2017, there were no consumer residential mortgages that were foreclosed on or received via a deed in lieu transaction prior to the period end. As of June 30, 2017, the Company has initiated formal foreclosure proceedings on eleven properties classified as consumer residential mortgages with a carrying value of \$630,000.

The following table shows the amount of loans in each category that were individually and collectively evaluated for impairment at the dates indicated:

	Real Estate Loans			Commercial Consumer		Total
	Residential	Commercial	Construction	Loans	Loans	
June 30, 2017	(In thousands)					
Individually evaluated for impairment	\$ 23	\$ 3,175	\$ -	\$ -	\$ -	\$ 3,198
Loans acquired with deteriorated credit quality	831	514	-	-	-	1,345
Collectively evaluated for impairment	233,397	331,913	17,673	84,502	63,194	730,679
Total Loans	\$ 234,251	\$ 335,602	\$ 17,673	\$ 84,502	\$ 63,194	\$ 735,222

	Real Estate Loans			Commercial Consumer		Total
	Residential	Commercial	Construction	Loans	Loans	
December 31, 2016	(In thousands)					
Individually evaluated for impairment	\$ 23	\$ 2,601	\$ -	\$ -	\$ -	\$ 2,624
Loans acquired with deteriorated credit quality	821	565	-	-	-	1,386
Collectively evaluated for impairment	236,333	317,021	19,709	85,508	51,524	710,095
Total Loans	\$ 237,177	\$ 320,187	\$ 19,709	\$ 85,508	\$ 51,524	\$ 714,105

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable.

	Recorded Investment	Unpaid Principal Balance	Associated Allowance
	(in thousands)		
June 30, 2017			
With no related allowance recorded:			
Real Estate Loans			
Residential	\$ 23	\$ 28	\$ -
Commercial	3,175	4,056	-
Subtotal	3,198	4,084	-
Total:			
Real Estate Loans			
Residential	23	28	-
Commercial	3,175	4,056	-
Total Impaired Loans	\$ 3,198	\$ 4,084	\$ -

	Recorded Investment	Unpaid Principal Balance	Associated Allowance
	(in thousands)		
December 31, 2016			
With no related allowance recorded:			
Real Estate Loans			
Residential	\$ 23	\$ 28	\$ -
Commercial	2,601	3,427	-
Subtotal	2,624	3,455	-
Total:			
Real Estate Loans			
Residential	23	28	-
Commercial	2,601	3,427	-
Total Impaired Loans	\$ 2,624	\$ 3,455	\$ -

The following table presents the average recorded investment in impaired loans and the related amount of interest income recognized during the three-month periods ended June 30, 2017 and 2016 (in thousands):

Average		Interest	
Recorded		Income	
Investment		Recognized	
2017	2016	2017	2016

Real Estate Loans:

Residential	\$ 23	\$ 157	\$ -	\$ 1
Commercial	2,821	3,146	29	25
Total	\$ 2,844	\$ 3,303	\$ 29	\$ 26

The following table presents the average recorded investment in impaired loans and the related amount of interest income recognized during the six-month periods ended June 30, 2017 and 2016 (in thousands):

	Average Recorded Investment		Interest Income Recognized	
	2017	2016	2017	2016
Real Estate Loans:				
Residential	\$ 23	\$ 161	\$ -	\$ 2
Commercial	2,730	3,218	51	57
Total	\$ 2,753	\$ 3,379	\$ 51	\$ 59

Troubled debt restructured loans are those loans whose terms have been renegotiated to provide a reduction or deferral of principal or interest as a result of financial difficulties experienced by the borrower, who could not obtain comparable terms from alternate financing sources. As of June 30, 2017, troubled debt restructured loans totaled \$1.4 million with no specific reserve. As of December 31, 2016, troubled debt restructured loans totaled \$1.5 million with no specific reserve. For the six month period ended June 30, 2017, there were no new loans identified as troubled debt restructurings. During 2017, the Company recognized a write-down of \$55,000 on one loan that was previously identified as a troubled debt restructuring with a carrying value of \$247,000 as of June 30, 2017.

For the six-month period ended June 30, 2016, there were no new loans identified as troubled debt restructurings. During the 2016 period, the Company recognized write-downs of \$2,519,000 on loans previously identified as a troubled debt restructuring. Additionally, one loan with a carrying value of \$2.5 million was transferred to Foreclosed Real Estate as a result of a foreclosure.

Management uses an eight point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first four categories are considered not criticized, and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as non performance, repossession, or death occurs to raise awareness of a possible credit event. The Company's Loan Review Department is responsible for the timely and accurate risk rating of the loans on an ongoing basis. Every credit which must be approved by Loan Committee or the Board of Directors is assigned a risk rating at time of consideration. Loan Review also annually reviews relationships of \$1,500,000 and over to assign or re-affirm risk ratings. Loans in the Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard, Doubtful and Loss within the internal risk rating system as of June 30, 2017 and December 31, 2016 (in thousands):

	Pass	Special Mention	Substandard	Doubtful or Loss	Total
June 30, 2017					
Commercial real estate loans	\$ 319,333	\$ 8,828	\$ 7,441	\$ -	\$ 335,602
Commercial loans	84,392	23	87	-	84,502
Total	\$ 403,725	\$ 8,851	\$ 7,528	\$ -	\$ 420,104

	Pass	Special Mention	Substandard	Doubtful or Loss	Total
December 31, 2016					
Commercial real estate loans	\$ 310,432	\$ 5,432	\$ 4,323	\$ -	\$ 320,187
Commercial loans	84,600	885	23	-	85,508
Total	\$ 395,032	\$ 6,317	\$ 4,346	\$ -	\$ 405,695

For residential real estate loans, construction loans and consumer loans, the Company evaluates credit quality based on the performance of the individual credits. The following table presents the recorded investment in the loan classes based on payment activity as of June 30, 2017 and December 31, 2016 (in thousands):

	Performing	Nonperforming	Total
June 30, 2017			
Residential real estate loans	\$ 232,774	\$ 1,307	\$ 234,251
Construction	17,673	15	17,673
Consumer loans	63,194	-	63,194
Total	\$ 313,641	\$ 1,322	\$ 315,118

	Performing	Nonperforming	Total
December 31, 2016			
Residential real estate loans	\$ 235,829	\$ 1,137	\$ 237,177
Construction	19,681	28	19,709
Consumer loans	51,524	-	51,524
Total	\$ 307,034	\$ 1,165	\$ 308,410

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of June 30, 2017 and December 31, 2016 (in thousands):

		Greater than 90 Days						
		31-60	61-90	Past Due		Total Past	Total	
	Current	Days Past Due	Days Past Due	and still accruing	Non-Accrual	Due and Non-Accrual	Loans	
June 30, 2017								
Real Estate loans								
Residential	\$232,011	\$737	\$192	\$ 4	\$ 1,307	\$ 2,240	\$234,251	
Commercial	333,182	1,034	-	-	1,386	2,420	335,602	
Construction	17,658	-	-	-	15	15	17,673	
Commercial loans	84,467	-	35	-	-	35	84,502	
Consumer loans	63,137	38	19	-	-	57	63,194	
Total	\$730,455	\$1,809	\$246	\$ 4	\$ 2,708	\$ 4,767	\$735,222	

		Greater than 90 Days						
		31-60	61-90	Past Due		Total Past	Total	
	Current	Days Past Due	Days Past Due	and still accruing	Non-Accrual	Due and Non-Accrual	Loans	
December 31, 2016								
Real Estate loans								
Residential	\$234,790	\$986	\$264	\$ 1	\$ 1,136	\$ 2,387	\$237,177	
Commercial	318,979	445	1	-	762	1,208	320,187	
Construction	19,681	-	-	-	28	28	19,709	
Commercial loans	85,355	143	10	-	-	153	85,508	
Consumer loans	51,456	39	29	-	-	68	51,524	
Total	\$710,261	\$1,613	\$304	\$ 1	\$ 1,926	\$ 3,844	\$714,105	

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the allowance for loan losses. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the allowance. The following table presents the allowance for loan losses by the classes of the loan portfolio:

(In thousands)	Residential		Commercial			Total
	Real Estate	Real Estate	Construction	Commercial	Consumer	
Beginning balance, December 31, 2016	\$ 1,092	\$ 4,623	\$ 78	\$ 307	\$ 363	\$6,463
Charge Offs	(83)	(96)	(13)	-	(82)	(274)
Recoveries	3	4	12	-	11	30
Provision for loan losses	242	697	16	53	192	1,200
Ending balance, June 30, 2017	\$ 1,254	\$ 5,228	\$ 93	\$ 360	\$ 484	\$7,419
Ending balance individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$-
Ending balance collectively evaluated for impairment	\$ 1,254	\$ 5,228	\$ 93	\$ 360	\$ 484	\$7,419

(In thousands)	Residential		Commercial			Total
	Real Estate	Real Estate	Construction	Commercial	Consumer	
Beginning balance, March 31, 2017	\$ 1,179	\$ 4,831	\$ 95	\$ 369	\$ 427	\$6,901
Charge Offs	(44)	(11)	(5)	-	(30)	(90)
Recoveries	2	2	-	-	4	8
Provision for loan losses	117	406	3	(9)	83	600
Ending balance, June 30, 2017	\$ 1,254	\$ 5,228	\$ 93	\$ 360	\$ 484	\$7,419

(In thousands)	Residential		Commercial			Total
	Real Estate	Real Estate	Construction	Commercial	Consumer	
Beginning balance, December 31, 2015	\$ 1,069	\$ 5,506	\$ 90	\$ 397	\$ 236	\$7,298
Charge Offs	(17)	(2,642)	-	-	(30)	(2,689)
Recoveries	2	2	-	-	35	39
Provision for loan losses	(78)	1,325	(31)	(104)	38	1,150
Ending balance, June 30, 2016	\$ 976	\$ 4,191	\$ 59	\$ 293	\$ 279	\$5,798
Ending balance individually evaluated for impairment	\$ -	\$ 15	\$ -	\$ -	\$ -	\$15
Ending balance collectively evaluated for impairment	\$ 976	\$ 4,176	\$ 59	\$ 293	\$ 279	\$5,783

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(In thousands)	Residential		Commercial			Total
	Real Estate	Real Estate	Construction	Commercial	Consumer	
Beginning balance, March 31, 2016	\$ 1,077	\$ 5,758	\$ 109	\$ 446	\$ 252	\$7,642
Charge Offs	(17)	(2,513)	-	-	(23)	(2,553)
Recoveries	1	-	-	-	8	9
Provision for loan losses	(85)	946	(50)	(153)	42	700
Ending balance, June 30, 2016	\$ 976	\$ 4,191	\$ 59	\$ 293	\$ 279	\$5,798

The Company's primary business activity as of June 30, 2017 was with customers located in northeastern Pennsylvania and the New York counties of Delaware and Sullivan. Accordingly, the Company has extended credit primarily to commercial entities and individuals in this area whose ability to honor their contracts is influenced by the region's economy.

As of June 30, 2017, the Company considered its concentration of credit risk to be acceptable. The highest concentrations are in commercial rentals with \$78.4 million of loans outstanding, or 10.7% of total loans outstanding, and the hospitality/lodging industry with loans outstanding of \$50.0 million, or 6.8% of loans outstanding. During 2017, the Company did not recognize any losses in the named concentrations.

The Company did not sell any residential mortgage loans during the first six months of 2017. Gross realized gains and gross realized losses on sales of residential mortgage loans were \$54,000 and \$0, respectively, in the first six months of 2016. The proceeds from the sales of residential mortgage loans totaled \$1.7 million for the six months ended June 30, 2016.

During the three months ended June 30, 2017, the Company sold \$1.7 million of USDA guaranteed commercial real estate loans. The gross realized gain on the sale was \$67,000.

Gross realized gains and gross realized losses on sales of residential mortgage loans were \$22,000 and \$0, respectively, in the three months ended June 30, 2016. The proceeds from the sales of residential mortgage loans totaled \$726,000 for the three months ended June 30, 2016.

8. Fair Value Measurements

Fair value estimates are based on quoted market prices, if available, quoted market prices of similar assets or liabilities, or the present value of expected future cash flows and other valuation techniques. These valuations are significantly affected by discount rates, cash flow assumptions and risk assumptions used. Therefore, fair value estimates may not be substantiated by comparison to independent markets and are not intended to reflect the proceeds that may be realizable in an immediate settlement of the instruments.

Fair value is determined at one point in time and is not representative of future value. These amounts do not reflect the total value of a going concern organization. Management does not have the intention to dispose of a significant portion of its assets and liabilities and therefore, the unrealized gains or losses should not be interpreted as a forecast of future earnings and cash flows.

The following is a discussion of assets and liabilities measured at fair value and valuation techniques applied:

Securities:

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain Level 3 investments, if applicable.

Impaired loans (generally carried at fair value):

The Company measures impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the lowest level of input that is significant to the fair value measurements.

Foreclosed real estate owned (carried at fair value):

Real estate properties acquired through, or in lieu of loan foreclosure are to be sold and are carried at fair value less estimated cost to sell. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. These assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2017 and December 31, 2016 are as follows:

Fair Value Measurement Using
Reporting Date

Description	Total	Level 1	Level 2	Level 3
	(In thousands)			
June 30, 2017				
Available for Sale:				
U.S. Treasury securities	\$ 1,994	\$ -	\$ 1,994	\$ -
States and political subdivisions	128,638	-	128,638	-
Corporate obligations	10,114	-	10,114	-
Mortgage-backed securities-government sponsored agencies	159,495	-	159,495	-
Equity securities-financial services	426	426	-	-
Total	\$ 300,667	\$ 426	\$ 300,241	\$ -

Description	Total	Level 1	Level 2	Level 3
	(In thousands)			

December 31, 2016

Available for Sale:

U.S. Treasury securities	\$ 1,997	\$ -	\$ 1,997	\$ -
States and political subdivisions	125,101	-	125,101	-
Corporate obligations	10,112	-	10,112	-
Mortgage-backed securities-government sponsored agencies	164,930	-	164,930	-
Equity securities-financial services	424	424	-	-
Total	\$ 302,564	\$ 424	\$ 302,140	\$ -

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For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2017 and December 31, 2016 are as follows:

Description	Total	Fair Value Measurement Reporting Date using Reporting Date		
		Level 1	Level 2	Level 3
(In thousands)				
June 30, 2017				
Impaired Loans	\$ 3,198	\$ -	\$ -	\$ 3,198
Foreclosed Real Estate Owned	4,523	-	-	4,523
December 31, 2016				
Impaired Loans	\$ 2,624	\$ -	\$ -	\$ 2,624
Foreclosed Real Estate Owned	5,302	-	-	5,302

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

(dollars in thousands)	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
June 30, 2017				
Impaired loans	\$ 2,063	Appraisal of collateral(1)	Appraisal adjustments(2)	10% (10%)
Impaired loans	\$ 1,135	Present value of future cash flows	Loan discount rate	4.00-5.25% (5.11%)
			Probability of default	0%
Foreclosed real estate owned	\$ 4,523	Appraisal of collateral(1)	Liquidation Expenses(2)	10%

(dollars in thousands)	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
December 31, 2016				
Impaired loans	\$ 1,473	Appraisal of collateral(1)	Appraisal adjustments(2)	10% (10%)

Impaired loans	\$ 1,151 Present value of future cash flows	Loan discount rate	4-5.25% (5.11%)
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Probability of default	0%
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Foreclosed real estate owned \$ 5,302	Appraisal of collateral(1)	Liquidation Expenses(2)	10%
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(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable, less any associated allowance.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at June 30, 2017 and December 31, 2016.

Cash and cash equivalents (carried at cost):

The carrying amounts reported in the consolidated balance sheet for cash and short-term instruments approximate those assets' fair values.

Securities:

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain Level 3 investments, if applicable.

Loans receivable (carried at cost):

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Impaired loans (generally carried at fair value):

Impaired loans (generally carried at fair value)

The Company measures impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the lowest level of input that is significant to the fair value measurements.

As of June 30, 2017, the fair value investment in impaired loans totaled \$3,198,000 which included eight loan relationships that did not require a valuation allowance since either the estimated realizable value of the collateral or the discounted cash flows exceeded the recorded investment in the loan. As of June 30, 2017, the Company has recognized charge-offs against the allowance for loan losses on these impaired loans in the amount of \$886,000 over the life of the loans.

As of December 31, 2016, the fair value investment in impaired loans totaled \$2,624,000 which included seven loans that did not require a valuation allowance since the estimated realizable value of the collateral exceeded the recorded investment in the loan. As of December 31, 2016, the Company had recognized charge-offs against the allowance for loan losses on these impaired loans in the amount of \$831,000 over the life of the loans.

Mortgage servicing rights (generally carried at cost)

The Company utilizes a third party provider to estimate the fair value of certain loan servicing rights. Fair value for the purpose of this measurement is defined as the amount at which the asset could be exchanged in a current transaction between willing parties, other than in a forced liquidation.

Foreclosed real estate owned (carried at fair value):

Real estate properties acquired through, or in lieu of loan foreclosure are to be sold and are carried at fair value less estimated cost to sell. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. These assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement.

Regulatory stock (carried at cost):

The Company, as a member of the Federal Home Loan Bank (FHLB) system is required to maintain an investment in capital stock of its district FHLB according to a predetermined formula. This regulatory stock has no quoted market value and is carried at cost.

Bank owned life insurance (carried at cost):

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

Accrued interest receivable and payable (carried at cost):

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Deposit liabilities (carried at cost except certificates of deposit which are at fair value):

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term borrowings (carried at cost):

The carrying amounts of short-term borrowings approximate their fair values.

Other borrowings (carried at cost):

Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Off-balance sheet financial instruments (disclosed at cost):

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

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The estimated fair values of the Bank's financial instruments were as follows at June 30, 2017 and December 31, 2016. (In thousands)

	Fair Value Measurements at June 30, 2017				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	\$ 16,403	\$ 16,403	\$ 16,403	\$ -	\$ -
Securities	300,667	300,667	426	300,241	-
Loans receivable, net	727,607	731,573	-	-	731,573
Mortgage servicing rights	215	239	-	-	239
Regulatory stock	2,435	2,435	2,435	-	-
Bank owned life insurance	36,575	36,575	36,575	-	-
Accrued interest receivable	3,417	3,417	3,417	-	-
Financial liabilities:					
Deposits	932,471	932,127	649,897	-	282,230
Short-term borrowings	42,192	42,192	42,192	-	-
Other borrowings	25,330	25,183	-	-	25,183
Accrued interest payable	942	942	942	-	-
Off-balance sheet financial instruments:					
Commitments to extend credit and outstanding letters of credit	-	-	-	-	-

	Fair Value Measurements at December 31, 2016				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	\$ 17,174	\$ 17,174	\$ 17,174	\$ -	\$ -
Securities	302,564	302,564	424	302,140	-
Loans receivable, net	707,426	716,661	-	-	716,661
Mortgage servicing rights	232	250	-	-	250
Regulatory stock	2,119	2,119	2,119	-	-
Bank owned life insurance	36,133	36,133	36,133	-	-
Accrued interest receivable	3,643	3,643	3,643	-	-
Financial liabilities:					
Deposits	925,385	925,561	629,829	-	295,732
Short-term borrowings	32,811	32,811	32,811	-	-
Other borrowings	32,001	31,863	-	-	31,863
Accrued interest payable	1,069	1,069	1,069	-	-

Off-balance sheet financial instruments:

Commitments to extend credit and outstanding letters of credit	-	-	-	-	-
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9. New and Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (a new revenue recognition standard). The Update's core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this Update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Because the guidance does not apply to revenue associated with financial instruments, including loans and securities, we do not expect the new standard, or any of the amendments, to result in a material change from our current accounting for revenue because the majority of the Company's financial instruments are not within the scope of Topic 606. However, we do expect that the standard will result in new disclosure requirements, which are currently being evaluated.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606). The amendments in this Update defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. The Company is evaluating the effect of adopting this new accounting Update.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. All entities that are not public business entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which (a) the lease term is 12 months or less and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the practical expedients it may elect at adoption, but does not anticipate the amendments will have a significant impact on the financial statements. Based on the Company's preliminary analysis of its current portfolio, the impact to the Company's balance sheet is estimated to result in less than a 1 percent increase in assets and liabilities. The Company also anticipates additional disclosures to be provided at adoption.

In March 2016, the FASB issued ASU 2016-04, Liabilities – Extinguishments of Liabilities (Subtopic 405-20). The standard provides that liabilities related to the sale of prepaid stored-value products within the scope of this Update are financial liabilities. The amendments in the Update provide a narrow-scope exception to the guidance in Subtopic 405-20 to require that breakage for those liabilities be accounted for consistent with the breakage guidance in Topic 606. The amendments in this Update are effective for public business entities, certain not-for-profit entities, and certain employee benefit plans for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Earlier application is permitted, including adoption in an interim period. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606). The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services (that are an output of the entity's ordinary activities) in exchange for consideration. The amendments in this Update do not change the core principle of the guidance in Topic 606; they simply clarify the implementation guidance on principal versus agent considerations. The amendments in this Update are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements of Update 2014-09. ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606). The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services in exchange for consideration. The amendments in this Update do not change the core principle for revenue recognition in Topic 606. Instead, the amendments provide (1) more detailed guidance in a few areas and (2) additional implementation guidance and examples based on feedback the FASB received from its stakeholders. The amendments are expected to reduce the degree of judgment necessary to comply with Topic 606, which the FASB expects will reduce the potential for diversity arising in practice and reduce the cost and complexity of applying the guidance. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from

Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements in Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606), which among other things clarifies the objective of the collectability criterion in Topic 606, as well as certain narrow aspects of Topic 606. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements for Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. This Update is not expected to have a significant impact on the Company's financial statements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which addresses eight specific cash flow issues with the objective of reducing diversity in practice. Among these include recognizing cash payments for debt prepayment or debt extinguishment as cash outflows for financing activities; cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage; and cash proceeds received from the settlement of bank-owned life insurance policies should be classified as cash inflows from investing activities while the cash payments for premiums on bank-owned policies may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The amendments in this Update should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date

practicable. The Company is currently evaluating the impact the adoption of the standard will have on the Company's statement of cash flows.

In October 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230), which requires that a statement of cash flows explains the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in this Update should be applied using a retrospective transition method to each period presented. The Company is currently evaluating the impact the adoption of the standard will have on the Company's statement of cash flows.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business, which provides a more robust framework to use in determining when a set of assets and activities (collectively referred to as a "set") is a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. Public business entities should apply the amendments in this Update to annual periods beginning after December 15, 2017, including interim periods within those periods. All other entities should apply the amendments to annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The amendments in this Update should be applied prospectively on or after the effective date. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment. To simplify the subsequent measurement of goodwill, the FASB eliminated Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this Update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A public business entity that is a U.S. Securities and Exchange Commission ("SEC") filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. A public business entity that is not an SEC filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2020. All other entities, including not-for-profit entities, that are adopting the amendments in this Update should do so for their annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2021. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20). The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public business entities, the amendments in this Update are effective

for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718), which affects any entity that changes the terms or conditions of a share-based payment award. This Update amends the definition of modification by qualifying that modification accounting does not apply to changes to outstanding share-based payment awards that do not affect the total fair value, vesting requirements, or equity/liability classification of the awards. The amendments in this Update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for (1) public business entities for reporting periods for which financial statements have not yet been issued and (2) all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments in this Update should be applied prospectively to an award modified on or after the adoption date. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2017, the FASB issued ASU 2017-10, Service Concession Arrangements (Topic 853), which applies to the accounting by operating entities for service concession arrangements within the scope of Topic 853. The amendments in this Update clarify that the grantor (government), rather than the third-party drivers, is the customer of the operation services in all cases for service concession arrangements within the scope of Topic 853. For an entity that has not adopted Topic 606 before the issuance of this Update, the effective date and transition requirements for the amendments in this Update generally are the same as the effective date and transition requirements for Topic 606 (and any other Topic amended by ASU 2014-09, Revenue from Contracts with Customers (Topic 606)). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, deferred the effective date of Update 2014-09 by one year. This Update is not expected to have a significant impact on the Company's financial statements.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), and Derivative and Hedging (Topic 815). The amendments in Part I of this Update change the classification analysis of certain equity-linked financial instruments (or embedded features) with down-round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down-round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments. As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down-round feature. For freestanding equity classified financial instruments, the amendments require entities that present earnings per share ("EPS") in accordance with Topic 260 to recognize the effect of the down-round feature when it is triggered. That effect is treated as a dividend and as a reduction of income available to common shareholders in basic EPS. Convertible instruments with embedded conversion options that have down-round features are now subject to the specialized guidance for contingent beneficial conversion features (in Subtopic 470-20, Debt—Debt with Conversion and Other Options), including related EPS guidance (in Topic 260). The amendments in Part II of this Update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Accounting Standards Codification, to a scope exception. Those amendments do not have an accounting effect. For public business entities, the amendments in Part I of this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments in Part I of this Update

are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in Part I of this Update should be applied either retrospectively to outstanding financial instruments with a down-round feature by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the first fiscal year and interim period(s) in which the pending content that links to this paragraph is effective or retrospectively to outstanding financial instruments with a down-round feature for each prior reporting period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10. The amendments in Part II of this Update do not require any transition guidance because those amendments do not have an accounting effect. This Update is not expected to have a significant impact on the Company's financial statements.

10. Acquisition of Delaware Bancshares, Inc.

On July 31, 2016, Norwood Financial Corp. (the "Company") closed on its acquisition of Delaware Bancshares, Inc. ("Delaware") pursuant to the terms of the Agreement and Plan of Merger, dated March 10, 2016, by and among the Company, Wayne Bank, Delaware and The National Bank of Delaware County (the "Merger Agreement").

Pursuant to the terms of the Merger Agreement, Delaware was merged with and into the Company, with the Company as the surviving corporation of the merger (the "Merger"). At the effective time of the Merger, each outstanding share of the common stock of Delaware was converted into, at the election of the holder but subject to the limitations and allocation and proration provisions set forth in the Merger Agreement, either \$16.68 in cash or 0.6221 of a share of the common stock, par value \$0.10 per share (the "Common Stock") of the Company. In the aggregate, the merger consideration paid to Delaware shareholders consisted of approximately \$3,860,000 in cash and 431,605 shares of Norwood common stock. Immediately following the Merger, The National Bank of Delaware County ("NBDC") was merged with and into Wayne Bank, a wholly-owned subsidiary of the Company, with Wayne Bank as the surviving entity.

In connection with the Merger, the Company assumed the obligations of Delaware under the Indenture, dated as of October 31, 2007, by and between Delaware, as issuer, and Wells Fargo Bank, National Association, as trustee (the "Indenture") and Delaware's Junior Subordinated Debt Securities, due January 1, 2038 (the "Debt Securities") issued thereunder. The Debt Securities were issued by Delaware in connection with a private placement completed on October 31, 2007 of \$8.0 million of trust preferred securities issued through the Delaware Bancshares Capital Trust I (the "Trust"). The proceeds from the initial sale of the trust preferred securities on October 31, 2007 were used by the Trust to purchase the Debt Securities. The Debt Securities bore interest at a variable rate which reset quarterly at LIBOR plus 2.4%, and were redeemable, in whole or in part, without penalty, at the option of the Company, beginning on January 1, 2013 and on any January 1, April 1, July 1 or October 1 thereafter. The interest payments on the Debt Securities made by the Company were used to pay the quarterly distributions payable by the Trust to the holders of the trust preferred securities. The Company redeemed the debt securities and the trust preferred securities in full on October 3, 2016.

The acquired assets and assumed liabilities were measured at estimated fair values. Management made significant estimates and exercised significant judgment in accounting for the acquisition. Management measured loan fair values based on loan file reviews, appraised collateral values, expected cash flows, and historical loss factors of NBDC. The Company also recorded an identifiable intangible asset representing the core deposit base of NBDC based on management's evaluation of the cost of such deposits relative to alternative funding sources. Management used significant estimates including the average lives of depository

accounts, future interest rate levels, and the cost of servicing various depository products. Management used market quotations to determine the fair value of investment securities.

The business combination resulted in the acquisition of loans with and without evidence of credit quality deterioration. NBDC loans were deemed impaired at the acquisition date if the Company did not expect to receive all contractually required cash flows due to concerns about credit quality. Such loans were fair valued and the difference between contractually required payments at the acquisition date and cash flows expected to be collected was recorded as a non-accretable difference. At the acquisition date, the Company recorded \$1,410,000 of purchased credit-impaired loans subject to a non-accretable difference of \$260,000. The method of measuring carrying value of purchased loans differs from loans originated by the Company (originated loans), and as such, the Company identifies purchased loans and purchased loans with a credit quality discount and originated loans at amortized cost.

NBDC's loans without evidence of credit deterioration were fair valued by discounting both expected principal and interest cash flows using an observable discount rate for similar instruments that a market participant would consider in determining fair value. Additionally, consideration was given to management's best estimates of default rates and payment speeds. At acquisition, NBDC's loan portfolio without evidence of deterioration totaled \$111,307,000 and was recorded at a fair value of \$109,693,000.

The following table summarizes the purchase of Delaware Bancshares, Inc. as of July 31, 2016:

(Dollars in Thousands, Except Per Share Data)

Purchase Price Consideration in Common Stock		
Delaware Bancshares, Inc. common shares settled for stock	694,114	
Exchange Ratio	0.6221	
Norwood Financial Corp. shares issued	431,605	
Value assigned to each Norwood Financial Corp. common share	\$ 28.15	
Purchase price assigned to Delaware Bancshares, Inc. common shares exchanged for Norwood Financial Corp. shares		\$ 12,150
Purchase Price Consideration - Cash for Common Stock		
Delaware Bancshares, Inc. shares exchanged for cash	231,385	
Purchase price paid to each Delaware Bancshares, Inc. common share exchanged for cash	\$ 16.68	
Purchase price assigned to Delaware Bancshares, Inc. common shares exchanged for cash		\$ 3,860
Purchase price consideration - Cash-in-lieu of Fractional Shares		6
Total Purchase Price		\$ 16,016
Net Assets Acquired:		
Delaware Bancshares, Inc. shareholders' equity	\$ 19,357	
Delaware Bancshares, Inc. goodwill and intangibles	(7,640)	
Total tangible equity	11,717	
Adjustments to reflect assets acquired at fair value:		
Investments	219	
Loans		
Interest rate	1,486	
General credit	(1,614)	
Specific credit - non-amortizing	(260)	
Specific credit - amortizing	(239)	
Core deposit intangible	449	
Deferred loan fees	(296)	
Premises and equipment	3,053	
Allowance for loan and lease losses	1,651	
Deferred tax assets	(1,417)	
Other	(97)	
Adjustments to reflect liabilities acquired at fair value:		
Time deposits	(252)	14,400
Goodwill resulting from merger		\$ 1,616

The following condensed statement reflects the values assigned to Delaware Bancshares, Inc. net assets as of acquisition date:

(In Thousands)

Total purchase price		\$ 16,016
Net assets acquired:		
Cash	\$ 14,977	
Securities available for sale	208,488	
Loans	116,674	
Premises and equipment, net	7,292	
Regulatory stock	279	
Accrued interest receivable	1,626	
Bank-owned life insurance	14,762	
Core deposit intangible	449	
Deferred tax assets	3,034	
Other assets	3,282	
Time deposits	(71,342)	
Deposits other than time deposits	(255,921)	
Borrowings	(21,232)	
Accrued interest payable	(95)	
Other liabilities	(7,873)	
		14,400
Goodwill resulting from Delaware Bancshares, Inc., Merger		\$ 1,616

The Company recorded goodwill and other intangibles associated with the purchase of Delaware Bancshares, Inc. totaling \$1,616,000. Goodwill is not amortized, but is periodically evaluated for impairment. The Company did not recognize any impairment during the six months ended June 30, 2017. The carrying amount of the goodwill at June 30, 2017 related to the Delaware acquisition was \$1,616,000.

Identifiable intangibles are amortized to their estimated residual values over the expected useful lives. Such lives are also periodically reassessed to determine if any amortization period adjustments are required. During the six months ended June 30, 2017, no such adjustments were recorded. The identifiable intangible assets consist of a core deposit intangible which is being amortized on an accelerated basis over the useful life of such assets. The gross carrying amount of the core deposit intangible at June 30, 2017 was \$449,000 with \$75,000 accumulated amortization as of that date.

As of June 30, 2017, the current year and estimated future amortization expense for the core deposit intangible is:

(In thousands)

2017	\$58
2018	70
2019	62
2020	54
2021	46
After five years	105
	\$395

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

Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words "believes," "anticipates," "contemplates," "expects," and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. Those risks and uncertainties include:

- our ability to realize the anticipated benefits from our acquisition of Delaware Bancshares, Inc.
- possible future impairment of intangible assets
- our ability to effectively manage future growth
- loan losses in excess of our allowance
- risks inherent in commercial lending
- real estate collateral which is subject to declines in value
- potential other-than-temporary impairments
- soundness of other financial institutions
- interest rate risks
- potential liquidity risk
- availability of capital
- regional economic factors
- loss of senior officers
- comparatively low legal lending limits
- risks of new capital requirements
- limited market for the Company's stock
- restrictions on ability to pay dividends
- common stock may lose value
- insider ownership
- issuing additional shares may dilute ownership
- competitive environment
- certain anti-takeover provisions
- extensive and complex governmental regulation and associated cost
- cybersecurity

Norwood Financial Corp. undertakes no obligation to publicly release the results of any revisions to those forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Critical Accounting Policies

Note 2 to the Company's consolidated financial statements for the year ended December 31, 2016 (incorporated by reference in Item 8 of the Form 10-K) lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of the Company and its results of operations.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of deferred tax assets, the fair value of financial instruments, the determination of goodwill impairment and the determination of other-than-temporary impairment on securities. Please refer to the discussion of the allowance for loan losses calculation under "Loans" in the "Changes in Financial Condition" section.

The Company uses the modified prospective transition method to account for stock options. Under this method companies are required to record compensation expense, based on the fair value of options over the vesting period. Restricted shares vest over a five-year period. The product of the number of shares granted and the grant date market price of the Company's common stock determines the fair value of restricted stock.

Deferred income taxes reflect temporary differences in the recognition of the revenue and expenses for tax reporting and financial statement purposes, principally because certain items are recognized in different periods for financial reporting and tax return purposes. Although realization is not assured, the Company believes that it is more likely than not that all deferred tax assets will be realized.

Management determines the appropriate classification of debt securities at the time of purchase and re-evaluates such designation as of each Consolidated Balance Sheet date.

Declines in the fair value of available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, the Company considers (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 of the Company to not sell the securities and whether it is more likely than not that it will not have to sell the securities before recovery of their cost basis. The Company believes that all unrealized losses on securities at June 30, 2017 and December 31, 2016 represent temporary impairment of the securities, related to changes in interest rates.

The Company, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of its district FHLB according to a predetermined formula. This restricted stock has no quoted market value and is carried at cost.

Management evaluates the restricted stock for impairment. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) 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, (2) 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, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

Management considered that the FHLB's regulatory capital ratios have increased from prior years, liquidity appears adequate, and the new shares of FHLB stock continue to change hands at the \$100 par value. Management believes no impairment charge is necessary related to FHLB stock as of June 30, 2017.

In connection with acquisitions, the Company recorded goodwill in the amount of \$11.3 million, representing the excess of amounts paid over the fair value of net assets of the institutions acquired in purchase transactions, at its fair value at the date of acquisition. Goodwill is tested and deemed impaired when the carrying value of goodwill exceeds its implied fair value. The value of the goodwill can change in the future. We expect the value of the goodwill to decrease if there is a significant decrease in the franchise value of the Company or the Bank. If an impairment loss is determined in the future, we will reflect the loss as an expense for the period in which the impairment is determined, leading to a reduction of our net income for that period by the amount of the impairment loss.

Changes in Financial Condition

General

Total assets as of June 30, 2017 were \$1.127 billion compared to \$1.111 billion as of December 31, 2016.

Securities

The fair value of securities available for sale as of June 30, 2017 was \$300.7 million compared to \$302.6 million as of December 31, 2016. The decrease in the securities portfolio is the result of sales, calls, maturities and principal reductions of securities.

The carrying value of the Company's securities portfolio (Available-for Sale) consisted of the following:

(dollars in thousands)	June 30, 2017		December 31, 2016			
	Amount	% of portfolio	Amount	% of portfolio		
U.S. Treasury securities	\$ 1,994	0.7	% \$ 1,997	0.7		%
States and political subdivisions	128,638	42.8	125,101	41.4		
Corporate obligations	10,114	3.4	10,112	3.3		
Mortgage-backed securities-						
government sponsored entities	159,495	53.0	164,930	54.5		
Equity securities-financial services	426	0.1	424	0.1		
Total	\$ 300,667	100.0	% \$ 302,564	100.0		%

The Company has securities in an unrealized loss position. In management's opinion, the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. Management believes that the unrealized losses on all holdings represent temporary impairment of the securities, as the Company has the intent and ability to hold these investments until maturity or market price recovery.

Loans

Loans receivable totaled \$735.0 million at June 30, 2017 compared to \$713.9 million as of December 31, 2016. The increase in loans receivable reflects a \$15.4 million increase in commercial real estate loans and an \$11.7 million increase in consumer loans.

The allowance for loan losses totaled \$7,419,000 as of June 30, 2017 and represented 1.01% of total loans outstanding, compared to \$6,463,000, or 0.91% of total loans, at December 31, 2016. The Company had net charge-offs for the six months ended June 30, 2017 of \$244,000 compared to \$2,650,000 in the corresponding period in 2016. The Company's management assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes an analysis of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and a historical review of credit losses by loan type. Other factors considered include concentration of credit in specific industries, economic and industry conditions, trends in delinquencies and loan classifications, and loan growth. Management considers the allowance adequate at June 30, 2017 based on the Company's criteria. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any, that might be incurred in the future.

As of June 30, 2017, non-performing loans totaled \$2.7 million, or 0.37% of total loans compared to \$1.9 million, or 0.25%, of total loans at December 31, 2016. At June 30, 2017, non-performing assets totaled \$7.2 million, or 0.64%, of total assets compared to \$7.2 million, or 0.64%, of total assets at December 31, 2016.

The following table sets forth information regarding non-performing loans and foreclosed real estate at the dates indicated:

(dollars in thousands)	June 30, 2017	December 31, 2016
Loans accounted for on a non-accrual basis:		
Real Estate		
Residential	\$ 1,307	\$ 1,136
Commercial	1,386	762
Construction	15	28
Commercial, financial and agricultural	-	-
Consumer loans to individuals	-	-
Total non-accrual loans *	2,708	1,926
Accruing loans which are contractually past due 90 days or more	4	1
Total non-performing loans	2,712	1,927
Foreclosed real estate	4,523	5,302
Total non-performing assets	\$ 7,235	\$ 7,229
Allowance for loans losses	\$ 7,419	\$ 6,463
Coverage of non-performing loans	273.56%	335.39%
Non-performing loans to total loans	0.37%	0.25%
Non-performing loans to total assets	0.24%	0.17%
Non-performing assets to total assets	0.64%	0.64%

*Includes non-accrual TDRs of \$396,000 as of June 30, 2017 and \$477,000 on December 31, 2016. The Company also had \$1.0 million of accruing TDRs on June 30, 2017 and December 31, 2016.

Deposits

During the six month period ending June 30, 2017, total deposits increased \$7.1 million due primarily to an \$8.9 million increase in non-interest bearing demand deposit accounts. Time deposits over \$100,000 decreased \$16.6 million due to the seasonal nature of the deposits, while all other deposits increased \$14.8 million. During the first quarter of 2017, the Company sold a community office and its \$13.9 million of deposits, including \$11.5 million of certificates of deposit.

The following table sets forth deposit balances as of the dates indicated:

(dollars in thousands)	June 30, 2017	December 31, 2016
Non-interest bearing demand	\$200,364	\$191,445
Interest bearing demand	97,851	93,485
Money market deposit accounts	155,535	153,020
Savings	196,147	191,878
Time deposits <\$100,000	161,169	157,564
Time deposits >\$100,000	121,405	137,993
Total	\$932,471	\$925,385

Borrowings

Other borrowings as of June 30, 2017 totaled \$25.3 million compared to \$32.0 million as of December 31, 2016. Short-term borrowings, which consist of securities sold under agreements to repurchase and overnight borrowings from the FHLB, increased \$9.4 million due to a \$4.9 million increase in repurchase agreement balances and a \$4.5 million increase in overnight borrowings.

Other borrowings consisted of the following:

(dollars in thousands)

	June 30, 2017	December 31, 2016
Notes with the FHLB:		
Convertible note due January 2017 at 4.710%	\$-	\$ 10,000
Amortizing fixed rate borrowing due December 2017 at 1.275%	2,019	4,025
Amortizing fixed rate borrowing due January 2018 at 0.910%	357	662
Amortizing fixed rate borrowing due December 2018 at 1.425%	1,230	1,634
Amortizing fixed rate borrowing due January 2019 at 1.393%	7,940	-
Amortizing fixed rate borrowing due June 2020 at 1.490%	6,089	7,078
Amortizing fixed rate borrowing due December 2020 at 1.706%	3,544	4,034
Amortizing fixed rate borrowing due March 2022 at 1.748%	4,151	4,568
	\$25,330	\$ 32,001

Stockholders' Equity and Capital Ratios

As of June 30, 2017, stockholders' equity totaled \$116.2 million, compared to \$111.1 million as of December 31, 2016. The net change in stockholders' equity included \$5.1 million of net income that was partially offset by \$2.7 million of dividends declared, and an \$854,000 decrease due to the acquisition of Treasury Stock, and a \$920,000 increase, net, due to the exercise and vesting of stock options and restricted stock. In addition, total equity increased \$2.6 million due to an increase in the fair value of securities in the available for sale portfolio, net of tax. This increase in fair value is the result of a change in interest rates and spreads, which may impact the value of the securities. Because of interest rate volatility, the Company's accumulated other comprehensive income (loss) could materially fluctuate for each interim and year-end period.

A comparison of the Company's consolidated regulatory capital ratios is as follows:

	June 30, 2017	December 31, 2016
Tier 1 Capital (To average assets)	9.34%	9.16%
Tier 1 Capital (To risk-weighted assets)	13.10%	13.27%
Common Equity Tier 1 Capital (To risk-weighted assets)	13.10%	13.27%
Total Capital (To risk-weighted assets)	14.04%	14.12%

Effective January 1, 2015, the Company and the Bank became subject to new regulatory capital rules, which, among other things, impose a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), set the minimum leverage ratio for all banking organizations at a uniform 4% of total assets, increase the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assign a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The new rules also require unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt out is exercised which the Company and the Bank have done. The final rule limits a banking organization's dividends, stock repurchases and other capital distributions, and certain discretionary bonus payments to executive officers, if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above regulatory minimum risk-based requirements. The capital conservation buffer requirement is being phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective. The Company and the Bank are in compliance with their respective new capital requirements, including the capital conservation buffer, as of June 30, 2017.

Liquidity

As of June 30, 2017, the Company had cash and cash equivalents of \$16.4 million in the form of cash, due from banks and short-term deposits with other institutions. In addition, the Company had total securities available for sale of \$300.7 million which could be used for liquidity needs. This totals \$317.1 million of liquidity and represents 28.1% of total assets compared to \$319.8 million and 28.8% of total assets as of December 31, 2016. The Company also monitors other liquidity measures, all of which were within the Company's policy guidelines as of June 30, 2017 and

December 31, 2016. Based upon these measures, the Company believes its liquidity is adequate.

Capital Resources

The Company has a line of credit commitment from Atlantic Community Bankers Bank for \$7,000,000 which expires June 30, 2018. There were no borrowings under this line as of June 30, 2017 and December 31, 2016.

The Company has a line of credit commitment available which has no stated expiration date from PNC Bank for \$16,000,000. There were no borrowings under this line as of June 30, 2017 and December 31, 2016.

The Company has a line of credit commitment available which has no stated expiration date from Zions Bank for \$17,000,000. There were no borrowings under this line as of June 30, 2017 and December 31, 2016.

The Bank's maximum borrowing capacity with the Federal Home Loan Bank was approximately \$346,460,000 as of June 30, 2017, of which \$29,803,000 and \$32,001,000 was outstanding at June 30, 2017 and December 31, 2016, respectively. Advances from the Federal Home Loan Bank are secured by qualifying assets of the Bank.

Non-GAAP Financial Measures

This report contains or references fully taxable-equivalent (fte) interest income and net interest income, which are non-GAAP financial measures. Interest income (fte) and net interest income (fte) are derived from GAAP interest income and net interest income using an assumed tax rate of 34%. We believe the presentation of interest income (fte) and net interest income (fte) ensures comparability of interest income and net interest income arising from both taxable and tax-exempt sources and is consistent with industry practice. Net interest income (fte) is reconciled to GAAP net interest income on pages 46 and 50. Although the Company believes that these non-GAAP financial measures enhance investors' understanding of our business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP measures.

NORWOOD FINANCIAL CORP.

Consolidated Average Balance Sheets with Resultant Interest and Rates

(Tax-Equivalent Basis, dollars in thousands)	Three Months Ended June 30,			2016		
	Average Balance (2)	Interest (1)	Average Rate (3)	Average Balance (2)	Interest (1)	Average Rate (3)
Assets						
Interest-earning assets:						
Interest bearing deposits with banks	\$ 9,717	\$ 24	0.99%	\$ 4,339	\$ 6	0.55%
Securities available for sale:						
Taxable	181,979	911	2.00	81,490	435	2.14
Tax-exempt (1)	122,285	1,094	3.58	58,262	670	4.60
Total securities available for sale (1)	304,264	2,005	2.64	139,752	1,105	3.16
Loans receivable (1) (4) (5)	724,125	8,096	4.47	569,923	6,487	4.55
Total interest-earning assets	1,038,106	10,125	3.90	714,014	7,598	4.26
Non-interest earning assets:						
Cash and due from banks	13,517			8,613		
Allowance for loan losses	(7,197)			(7,047)		
Other assets	76,954			48,492		
Total non-interest earning assets	83,274			50,058		
Total Assets	\$ 1,121,380			\$ 764,072		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Interest bearing demand and money market	\$ 251,904	\$ 100	0.16	\$ 181,171	\$ 77	0.17
Savings	199,015	25	0.05	79,690	9	0.05
Time	288,191	672	0.93	195,710	494	1.01
Total interest-bearing deposits	739,110	797	0.43	456,571	580	0.51
Short-term borrowings	33,917	28	0.33	45,631	38	0.33
Other borrowings	26,944	101	1.50	37,669	222	2.36
Total interest-bearing liabilities	799,971	926	0.46	539,871	840	0.62
Non-interest bearing liabilities:						
Demand deposits	196,129			116,072		
Other liabilities	9,590			4,385		
Total non-interest bearing liabilities	205,719			120,457		
Stockholders' equity	115,690			103,744		
Total Liabilities and Stockholders' Equity	\$ 1,121,380			\$ 764,072		
Net interest income (tax equivalent basis)		9,199	3.44%		6,758	3.63%
Tax-equivalent basis adjustment		(543)			(364)	
Net interest income		\$ 8,656			\$ 6,394	
Net interest margin (tax equivalent basis)			3.54%			3.79%

(1) Interest and yields are presented on a tax-equivalent basis using a marginal tax rate of 34%.

(2) Average balances have been calculated based on daily balances.

(3) Annualized

(4) Loan balances include non-accrual loans and are net of unearned income.

(5) Loan yields include the effect of amortization of deferred fees, net of costs.

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Rate/Volume Analysis. The following table shows the fully taxable equivalent effect of changes in volumes and rates on interest income and interest expense.

	Increase/(Decrease)		
	Three months ended		
	June 30, 2017		
	Compared to		
	Three months ended		
	June 30, 2016		
	Variance due to		
	Volume	Rate	Net
	(dollars in thousands)		
Interest earning assets:			
Interest bearing deposits with banks	\$ 10	\$ 8	\$ 18
Securities available for sale:			
Taxable	536	(60)	476
Tax-exempt securities	679	(255)	424
Total securities	1,215	(315)	900
Loans receivable	1,752	(143)	1,609
Total interest earning assets	2,977	(450)	2,527
Interest bearing liabilities:			
Interest-bearing demand and money market	29	(6)	23
Savings	16	-	16
Time	231	(53)	178
Total interest bearing deposits	276	(59)	217
Short-term borrowings	(10)	-	(10)
Other borrowings	(49)	(72)	(121)
Total interest bearing liabilities	217	(131)	86
Net interest income (tax-equivalent basis)	\$ 2,760	\$ (319)	\$ 2,441

Changes in net interest income that could not be specifically identified as either a rate or volume change were allocated proportionately to changes in volume and changes in rate.

Comparison of Operating Results for The Three Months Ended June 30, 2017 to June 30, 2016General

For the three months ended June 30, 2017, net income totaled \$2,724,000 compared to \$1,878,000 earned in the similar period in 2016. The increase in net income for the three months ended June 30, 2017 was due primarily to a \$2.3 million improvement in net interest income due to the increased size of the balance sheet resulting from the acquisition of Delaware Bancshares, Inc. in the third quarter of 2016. Other income (excluding gains on sales) increased \$558,000 due to increases in fee income from the accounts acquired, and from earnings on bank-owned life insurance relating to the acquisition. All operating expense categories increased \$1.6 million, net, due to the twelve branch offices acquired. Earnings per share for the current period were \$0.66 per share for basic and \$0.65 per fully diluted share compared to \$0.51 per share for basic and fully diluted shares for the three months ended June 30, 2016. The resulting annualized return on average assets and annualized return on average equity for the three months ended June 30, 2017 were 0.97% and 9.45%, respectively, compared to 0.99% and 7.28%, respectively, for the similar period in 2016.

The following table sets forth changes in net income:

(dollars in thousands)	Three months ended June 30, 2017 to June 30, 2016
Net income three months ended June 30, 2016	\$ 1,878
Change due to:	
Net interest income	2,262
Provision for loan losses	100
Net gains on sales	(125)
Other income	558
Salaries and employee benefits	(964)
Occupancy, furniture and equipment	(322)
Foreclosed real estate	280
All other expenses	(596)
Income tax expense	(347)
Net income three months ended June 30, 2017	\$ 2,724

Net Interest Income

Net interest income on a fully taxable equivalent basis (fte) for the three months ended June 30, 2017 totaled \$9,199,000 which was \$2,441,000 higher than the comparable period in 2016. The increase in net interest income includes a \$1,609,000 increase in interest income (fte) on loans and a \$900,000 increase in interest income (fte) on securities resulting primarily from the acquisition. The fte net interest spread and net interest margin were 3.44% and 3.54%, respectively, for the three months ended June 30, 2017 compared to 3.63% and 3.79%, respectively, for the similar period in 2016. The decrease in the net interest spread and the net interest margin reflects the mix of the balance sheet resulting from the acquisition.

Interest income (fte) totaled \$10,125,000 with a yield on average earning assets of 3.90% compared to \$7,598,000 and 4.26% for the 2016 period. Average loans increased \$154.2 million over the comparable period of last year primarily due to the acquisition, while average securities increased \$164.5 million. Average earning assets totaled \$1.038 billion for the three months ended June 30, 2017, an increase of \$324.1 million over the average for the similar period in 2016 due to the acquisition.

Interest expense for the three months ended June 30, 2017 totaled \$926,000 at an average cost of 0.46% compared to \$840,000 and 0.62% for the similar period in 2016. The decline in average cost reflects the increase in lower costing deposits acquired. The cost of time deposits, which is the most significant component of funding, decreased to 0.93% from 1.01% for the similar period in the prior year.

Provision for Loan Losses

The Company's provision for loan losses for the three months ended June 30, 2017 was \$600,000 compared to \$700,000 for the three months ended June 30, 2016. The Company makes provisions for loan losses in an amount necessary to maintain the allowance for loan losses at an acceptable level. Net charge-offs were \$82,000 for the quarter ended June 30, 2017 compared to \$2,544,000 for the similar period in 2016.

Other Income

Other income totaled \$1,656,000 for the three months ended June 30, 2017 compared to \$1,223,000 for the similar period in 2016. Service charges and fees increased \$412,000 due primarily to the accounts acquired, while other fee income categories increased \$146,000, net. Net gains from sales decreased \$125,000 due to a \$174,000 reduction in net gains from sales of securities.

Other Expense

Other expense for the three months ended June 30, 2017 totaled \$6,130,000 which was \$1,602,000 higher than the same period of 2016 due primarily to costs related to the operations of the offices acquired. Expenses related to foreclosed real estate decreased \$280,000.

Income Tax Expense

Income tax expense totaled \$858,000 for an effective tax rate of 24.0% for the period ending June 30, 2017 compared to \$511,000 for an effective tax rate of 21.4% for the similar period in 2016. The increase in the effective tax rate reflects an increase in the amount of taxable income.

Results of Operations
NORWOOD FINANCIAL CORP.
Consolidated Average Balance Sheets with Resultant Interest and Rates

(Tax-Equivalent Basis, dollars in thousands)	Six Months Ended June 30,					
	2017			2016		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
	(2)	(1)	(3)	(2)	(1)	(3)
Assets						
Interest-earning assets:						
Interest bearing deposits with banks	\$ 7,288	\$ 35	0.96%	\$ 2,750	\$ 7	0.51%
Securities available for sale:						
Taxable	183,440	1,803	1.97	81,681	877	2.15
Tax-exempt (1)	122,368	2,194	3.59	58,723	1,349	4.59
Total securities available for sale (1)	305,808	3,997	2.61	140,404	2,226	3.17
Loans receivable (1) (4) (5)	721,703	16,074	4.45	566,975	12,750	4.50
Total interest-earning assets	1,034,799	20,106	3.89	710,129	14,983	4.22
Non-interest earning assets:						
Cash and due from banks	13,711			8,363		
Allowance for loan losses	(6,960)			(7,282)		
Other assets	76,043			47,881		
Total non-interest earning assets	82,794			48,962		
Total Assets	\$ 1,117,593			\$ 759,091		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Interest-bearing demand and money market	\$ 250,024	\$ 194	0.16	\$ 177,403	\$ 152	0.17
Savings	197,387	49	0.05	78,189	19	0.05
Time	291,154	1,320	0.91	197,399	990	1.00
Total interest-bearing deposits	738,565	1,563	0.42	452,991	1,161	0.51
Short-term borrowings	33,703	56	0.33	47,348	77	0.33
Other borrowings	29,634	244	1.65	38,804	453	2.33
Total interest bearing liabilities	801,902	1,863	0.46	539,143	1,691	0.63
Non-interest bearing liabilities:						
Demand deposits	192,412			112,516		
Other liabilities	9,042			4,131		
Total non-interest bearing liabilities	201,454			116,647		
Stockholders' equity	114,237			103,301		
Total Liabilities and Stockholders' Equity	\$ 1,117,593			\$ 759,091		
Net interest income (tax equivalent basis)		18,243	3.42%		13,292	3.59%
Tax-equivalent basis adjustment		(1,089)			(723)	
Net interest income		\$ 17,154			\$ 12,569	
Net interest margin (tax equivalent basis)			3.53%			3.74%

(1) Interest and yields are presented on a tax-equivalent basis using a marginal tax rate of 34%.

(2) Average balances have been calculated based on daily balances.

(3) Annualized

- (4) Loan balances include non-accrual loans and are net of unearned income.
- (5) Loan yields include the effect of amortization of deferred fees, net of costs.

Rate/Volume Analysis. The following table shows the fully taxable equivalent effect of changes in volumes and rates on interest income and interest expense.

	Increase/(Decrease)		
	Six months ended June		
	30, 2017 Compared to		
	Six months ended June		
	30, 2016		
	Variance due to		
	Volume	Rate	Net
	(dollars in thousands)		
Interest earning assets:			
Interest bearing deposits with banks	\$ 16	\$ 12	\$ 28
Securities available for sale:			
Taxable	1,078	(152)	926
Tax-exempt securities	1,347	(502)	845
Total securities	2,425	(654)	1,771
Loans receivable	3,501	(177)	3,324
Total interest earning assets	5,942	(819)	5,123
Interest bearing liabilities:			
Interest-bearing demand and money market	55	(13)	42
Savings	30	-	30
Time	451	(121)	330
Total interest bearing deposits	536	(134)	402
Short-term borrowings	(21)	-	(21)
Other borrowings	(90)	(119)	(209)
Total interest bearing liabilities	425	(253)	172
Net interest income (tax-equivalent basis)	\$ 5,517	\$ (566)	\$ 4,951

Comparison of Operating Results for The Six Months Ended June 30, 2017 to June 30, 2016

General

For the six months ended June 30, 2017, net income totaled \$5,100,000 compared to \$3,754,000 earned in the similar period in 2016. The increase in net income for the six months ended June 30, 2017 was due primarily to a \$4.6 million improvement in net interest income due to the increased size of the balance sheet resulting from the acquisition of Delaware Bancshares, Inc. in the third quarter of 2016. Other income (excluding net gains on sales) increased \$1,013,000 due to increases in fee income from the accounts acquired. Gains from sales included a \$209,000 gain resulting from the sale of deposits and the Company's former West Scranton Office in the first quarter of 2017. All operating expense categories increased \$3.9 million, net, due to the twelve branch offices acquired. Earnings per share for the current period were \$1.23 per share for basic and \$1.22 per fully diluted shares compared to \$1.02 per share for basic and fully diluted shares for the six months ended June 30, 2016. The resulting annualized return on average assets and annualized return on average equity for the six months ended June 30, 2017 were 0.92% and 9.00%, respectively, compared to 0.99% and 7.31%, respectively, for the similar period in 2016.

The following table sets forth changes in net income: