

NORWOOD FINANCIAL CORP
Form 10-Q
November 08, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

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 0-28366

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

Pennsylvania
(State or other jurisdiction of
Incorporation or organization)

23-2828306
(I.R.S. employer identification no.)

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

18431
(Zip Code)

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

NA

(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 or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Edgar Filing: NORWOOD FINANCIAL CORP - Form 10-Q

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

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

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 November 1, 2011
Common stock, par value \$0.10 per share	3,292,366

NORWOOD FINANCIAL CORP.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2011

	Page Number
PART I - CONSOLIDATED FINANCIAL INFORMATION OF NORWOOD FINANCIAL CORP.	
Item 1. Financial Statements	3
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	11
Item 3. Quantitative and Qualitative Disclosures about Market Risk	45
Item 4. Controls and Procedures	46
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	47
Item 1A. Risk Factors	47
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	47
Item 3. Defaults upon Senior Securities	47
Item 4. Removed and Reserved	47
Item 5. Other Information	47
Item 6. Exhibits	47
Signatures	49

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NORWOOD FINANCIAL CORP.

Consolidated Balance Sheets (unaudited)

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

	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	\$ 12,472	\$ 5,782
Interest bearing deposits with banks	25,577	7,843
Federal funds sold	-	3,000
Cash and cash equivalents	38,049	16,625
Securities available for sale, at fair value	145,734	145,815
Securities held to maturity, fair value 2011: \$177, 2010: \$179	171	170
Loans receivable (net of unearned income)	454,832	356,855
Less: Allowance for loan losses	5,345	5,616
Net loans receivable	449,487	351,239
Investment in Federal Home Loan Bank Stock, at cost	3,782	3,361
Bank premises and equipment, net	7,601	4,904
Bank owned life insurance	11,767	8,249
Accrued interest receivable	2,758	2,166
Foreclosed real estate owned	3,355	748
Goodwill	9,483	13
Other intangibles	840	-
Other assets	5,854	3,715
TOTAL ASSETS	\$ 678,881	\$ 537,005
LIABILITIES		
Deposits:		
Non-interest bearing demand	\$ 78,500	\$ 62,238
Interest-bearing	448,013	331,627
Total deposits	526,513	393,865
Short-term borrowings	31,976	33,309
Other borrowings	27,716	38,000
Accrued interest payable	1,489	1,536
Other liabilities	4,274	2,597
TOTAL LIABILITIES	591,968	469,307
STOCKHOLDERS' EQUITY		
Common stock, \$.10 par value per share, authorized 10,000,000; shares issued 2011:3,371,866 shares, 2010: 2,840,872 shares	337	284
Surplus	24,647	9,826
Retained earnings	61,296	58,648
Treasury stock at cost: 2011: 79,500 shares, 2010: 72,068 shares	(2,404)	(2,197)
Accumulated other comprehensive income	3,037	1,137
TOTAL STOCKHOLDERS' EQUITY	86,913	67,698

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$	678,881	\$	537,005
--	----	---------	----	---------

See accompanying notes to the unaudited consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
INTEREST INCOME				
Loans receivable, including fees	\$6,521	\$5,266	\$16,917	\$15,894
Securities	1,116	1,115	3,341	3,477
Other	18	14	42	43
Total interest income	7,655	6,395	20,300	19,414
INTEREST EXPENSE				
Deposits	1,054	1,031	2,871	3,332
Short-term borrowings	24	26	75	87
Other borrowings	314	419	992	1,247
Total interest expense	1,392	1,476	3,938	4,666
NET INTEREST INCOME	6,263	4,919	16,362	14,748
PROVISION FOR LOAN LOSSES	425	250	1,075	730
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,838	4,669	15,287	14,018
OTHER INCOME				
Service charges and fees	581	587	1,722	1,680
Income from fiduciary activities	106	121	324	300
Net realized gains on sales of securities	544	161	768	380
Gains on sale of loans and servicing rights	41	3	282	208
Other	234	163	611	485
Total other income	1,506	1,035	3,707	3,053
OTHER EXPENSES				
Salaries and employee benefits	2,129	1,657	5,662	4,844
Occupancy, furniture & equipment, net	489	388	1,295	1,190
Data processing related	233	195	635	607
Taxes, other than income	142	77	414	374
Professional fees	171	81	296	358
Merger related expenses	16	-	771	-
Federal Deposit Insurance Corporation insurance assessment	102	121	317	357
Foreclosed real estate owned	372	3	408	32
Other	700	590	2,026	1,686
Total other expenses	4,354	3,112	11,824	9,448
INCOME BEFORE INCOME TAXES	2,990	2,592	7,170	7,623
INCOME TAX EXPENSE	775	702	1,811	2,118
NET INCOME	\$2,215	\$1,890	\$5,359	\$5,505
BASIC EARNINGS PER SHARE	\$.67	\$.68	\$1.79	\$1.99
DILUTED EARNINGS PER SHARE	\$.67	\$.68	\$1.79	\$1.99

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.

Consolidated Statements of Changes in Stockholders' Equity (unaudited)

Nine Months Ended September 30, 2011

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

	Common Stock			Retained	Treasury Stock		Accumulated Other Comprehensive	Total
	Shares	Amount	Surplus	Earnings	Shares	Amount	Income	
Balance December 31, 2010	2,840,872	\$284	\$9,826	\$58,648	72,068	\$(2,197)	\$ 1,137	\$67,698
Comprehensive Income:								
Net Income				5,359				5,359
Change in unrealized gains on securities available for sale, net of reclassification adjustments and tax effects							1,900	1,900
Total comprehensive income								7,259
Cash dividends declared \$.87 per share				(2,711)				(2,711)
Acquisition of treasury stock					7,432	(207)		(207)
Compensation expense related to stock options			126					126
Effect of North Penn acquisition	530,994	53	14,695					14,748
Balance, September 30, 2011	3,371,866	\$337	\$24,647	\$61,296	79,500	\$(2,404)	\$ 3,037	\$86,913

See accompanying notes to the unaudited consolidated financial statements.

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

	Nine Months Ended September 30,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$5,359	\$5,505
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,075	730
Depreciation	369	347
Amortization of intangible assets	68	39
Deferred income taxes	(31)	(36)
Net amortization of securities premiums and discounts	564	273
Net realized gain on sales of securities	(768)	(380)
Net increase in value of life insurance	(299)	(270)
Loss (gain) on sale of bank premises and equipment and foreclosed real estate	54	(3)
Net gain on sale of mortgage loans and servicing rights	(282)	(208)
Mortgage loans originated for sale	(8,677)	(10,537)
Proceeds from sale of mortgage loans originated for sale	8,959	10,745
Compensation expense related to stock options	126	122
Decrease in accrued interest receivable and other assets	2,049	569
Increase (decrease) in accrued interest payable and other liabilities	675	(14)
Net cash provided by operating activities	9,241	6,882
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available for sale:		
Proceeds from sales	27,734	23,778
Proceeds from maturities and principal reductions on mortgage-backed securities	23,180	51,704
Purchases	(35,043)	(82,518)
Securities held to maturity, proceeds from maturities	-	540
Redemption of FHLB stock	527	-
Net decrease in loans	15,975	3,886
Purchase of bank premises and equipment	(135)	(175)
Proceeds from sale of bank premises and equipment and foreclosed real estate	346	100
Acquisition, net of cash and cash equivalents acquired	4,544	-
Net cash provided by (used in) investing activities	37,128	(2,685)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net (decrease) increase in deposits	(2,786)	7,179
Net decrease in short-term borrowings	(1,333)	(1,274)
Repayments of other borrowings	(18,060)	(5,000)
Stock options exercised	-	111
Tax benefit of stock options exercised	-	32
Acquisition of treasury stock	(207)	(529)
Cash dividends paid	(2,559)	(2,318)
Net cash used in financing activities	(24,945)	(1,799)
Increase in cash and cash equivalents	21,424	2,398

Edgar Filing: NORWOOD FINANCIAL CORP - Form 10-Q

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	16,625	17,355
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$38,049	\$19,753

See accompanying notes to the unaudited consolidated financial statements.

6

Notes to the Unaudited Consolidated Financial Statements

1. 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, Norpenco, Inc. and WTRO Properties. 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 nine month period ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011 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, 2010.

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 reflects 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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Basic EPS weighted average shares outstanding	3,292	2,760	3,001	2,762
Dilutive effect of stock options	1	4	1	5
Diluted EPS weighted average shares outstanding	3,293	2,764	3,002	2,767

Stock options which had no intrinsic value, because their effect would be anti-dilutive and therefore would not be included in the diluted EPS calculation were 165,150 and 113,150 as of September 30, 2011 and 2010, respectively, based upon the closing price of Norwood common stock of \$24.02 and \$28.00 per share on September 30, 2011 and 2010, respectively.

3. Stock-Based Compensation

The Company's shareholders approved the Norwood Financial Corp 2006 Stock Option Plan at the annual meeting on April 25, 2006 and the Company awarded 47,700 options in 2006, 22,000 options in 2007, 24,000 options in 2008, 27,000 options in 2009, 28,000 options in 2010 and 1,000 in 2011, all of which have a twelve month vesting period. As of September 30, 2011, there was \$44,000 of total unrecognized compensation cost related to non-vested options granted in 2010 and 2011 under the plan, which will be fully amortized by December 31, 2011.

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	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2011	189,639	\$ 28.52	6.6 Yrs.	\$ 146
Granted	1,000	26.27	9.75 Yrs.	-
Exercised	-	-	-	-
Outstanding at September 30, 2011	190,639	\$ 28.51	5.8 Yrs.	\$ 44
Exercisable at September 30, 2011	162,639	\$ 28.65	4.4 Yrs.	\$ 44

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 \$24.02 as of September 30, 2011 and \$27.77 as of December 31, 2010. During the nine months ended September 30, 2011, no stock options were exercised.

4. Cash Flow Information

For the purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks all of which mature within 90 days and federal funds sold.

Cash payments for interest for the nine months ended September 30, 2011 and 2010 were \$3,985,000 and \$5,071,000, respectively. Cash payments for income taxes for the periods ending September 30, 2011 and 2010 were \$1,409,000 and \$1,990,000, respectively. Non-cash investing activity for 2011 and 2010 included repossession of other assets and foreclosed mortgage loans transferred to real estate owned of \$3,051,000 and \$564,000, respectively.

5. Comprehensive Income

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The components of other comprehensive income and related tax effects are as follows:

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Unrealized holding gains				
on available for sale securities	\$2,020	\$908	\$3,647	\$1,970
Reclassification adjustment for gains				
realized in income	(544)	(161)	(768)	(380)
Net unrealized gains	1,476	747	2,879	1,590
Income tax expense	502	254	979	541
Other comprehensive income	\$974	\$493	\$1,900	\$1,049

6. 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)	September 30,	
	2011	2010
Commitments to grant loans	\$37,649	\$19,867
Unfunded commitments under lines of credit	31,183	30,992
Standby letters of credit	11,960	3,195
	\$80,792	\$54,054

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 September 30, 2011 for guarantees under standby letters of credit issued is not material.

7. Securities

The amortized cost and fair value of securities were as follows:

	Amortized Cost	September 30, 2011		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
		(In thousands)		
Available for Sale:				
U.S. Government agencies	\$16,335	\$277	\$-	\$16,612
States and political subdivisions	55,512	1,923	(72)	57,363
Corporate obligations	7,732	168	(16)	7,884
Mortgage-backed securities- government sponsored entities	61,290	2,251	(10)	63,531
	\$140,869	\$4,619	\$(98)	145,390
Equity securities-financial services	257	90	(3)	344
	\$141,126	\$4,709	\$(101)	145,734
Held to Maturity:				
States and political subdivisions	\$171	\$6	\$-	\$177
		December 31, 2010		
		Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In thousands)		
Available for Sale:				
U.S. Government agencies	\$30,194	\$392	\$(318)	\$30,268
States and political subdivisions	49,880	510	(624)	49,766
Corporate obligations	4,018	231	-	4,249
Mortgage-backed securities-government sponsored entities	59,770	1,398	(240)	60,928
	143,862	2,531	(1,182)	145,211
Equity securities-financial services	224	381	(1)	604
	\$144,086	\$2,912	\$(1,183)	\$145,815
Held to Maturity:				
States and political subdivisions	\$170	\$9	\$-	\$179

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):

	September 30, 2011					
	Less than 12 Months		12 Months or More		Total	Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	
States and political subdivisions	\$4,270	\$(72)	\$-	\$-	\$4,270	\$(72)
Corporate obligations	1,016	(16)	-	-	1,016	(16)
Mortgage-backed securities-government sponsored agencies	2,588	(10)	-	-	2,588	(10)
Equity securities-financial services	\$34	\$(2)	15	(1)	49	(3)
	\$7,908	\$(100)	\$15	\$(1)	\$7,923	\$(101)

	December 31, 2010					
	Less than 12 Months		12 Months or More		Total	Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	
U.S. Government agencies	\$8,696	\$(318)	\$-	\$-	\$8,696	\$(318)
States and political subdivisions	21,829	(624)	-	-	21,829	(624)
Mortgage-backed securities-government sponsored agencies	20,113	(240)	-	-	20,113	(240)
Equity securities-financial services	15	(1)	-	-	15	(1)
	\$50,653	\$(1,183)	\$-	\$-	\$50,653	\$(1,183)

At September 30, 2011, the Company has 11 debt securities in an unrealized loss position in the less than twelve months category and no debt securities in the twelve months or more category. In Management's opinion the unrealized losses less than twelve months principally reflect changes in interest rates subsequent to the acquisition of specific securities. The Company holds a small amount of equity securities in other financial institutions. The value of these equity securities has been impacted by the overall weakness in the financial sector, one of which has been in a loss position for greater than one year. Management believes that the other unrealized loss represents temporary impairment of the security as the Company does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis.

The amortized cost and fair value of debt securities as of September 30, 2011 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		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Due in one year or less	\$1,118	\$1,121	\$-	\$-
Due after one year through five years	21,715	22,167	171	177
Due after five years through ten years	23,995	24,830	-	-
Due after ten years	32,751	33,741	-	-
Mortgage-backed securities-government sponsored agencies	61,290	63,531	-	-
	\$140,869	\$145,390	\$171	\$177

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

	Three Months Ended		Nine Months Ended	
	September 30, 2011	2010	September 30, 2011	2010
Gross realized gains	\$548	\$161	\$776	\$380
Gross realized losses	(4)	-	(8)	-
Net realized gain	\$544	\$161	\$768	\$380
Proceeds from sales of securities	\$17,390	\$11,091	\$27,734	\$23,778

8. Loans Receivable and Allowance for Loan Losses

Included in the 2011 growth are balances acquired from North Penn, as of the acquisition date, as follows (in thousands):

Real Estate – Residential	\$ 36,221
Commercial	70,789
Construction	358
Commercial, financial and agricultural	10,499
Consumer loans to individuals	1,831
Total loans	\$ 119,698

Set forth below is selected data relating to the composition of the loan portfolio at the dates indicated:

	Types of loans (dollars in thousands)					
	September 30, 2011			December 31, 2010		
Real Estate- Residential	\$ 148,925	32.7	%	\$ 124,562	34.9	%
Commercial	256,964	56.5		184,094	51.5	
Construction	11,486	2.5		12,638	3.5	
Commercial, financial and agricultural	23,343	5.1		22,386	6.3	
Consumer loans to individuals	14,524	3.2		13,668	3.8	
Total loans	455,242	100.0	%	357,348	100.0	%
Deferred fees (net)	(410)			(493)		
	454,832			356,855		
Less: Allowance for loan losses	5,345			5,616		
Net loans receivable	\$449,487			\$351,239		

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date without a carryover of the related allowance for loan losses.

Upon acquisition, the Company evaluated whether each acquired loan (regardless of size) was within the scope of ASC 310-30, Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality. Purchased credit-impaired loans are loans that have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. The carrying value of purchased loans acquired with deteriorated credit quality was \$1.5 million at June 30, 2011. There were no material increases or decreases in the expected cash flows of these loans between May 31, 2011 (the “acquisition date”) and September 30, 2011. The fair value of purchased credit-impaired loans, on the acquisition date, was determined, primarily based on the fair value of loan collateral.

On the acquisition date, the preliminary estimate of the unpaid principal balance for all loans evidencing credit impairment acquired in the North Penn acquisition was \$1.9 million and the estimated fair value of the loans was \$1.5 million. Total contractually required payments on these loans, including interest, at the acquisition date was \$3.6 million. However, the Company's preliminary estimate of expected cash flows was \$1.9 million. At such date, the Company established a credit risk related non-accretable discount (a discount representing amounts which are not expected to be collected from the customer nor liquidation of collateral) of \$1.7 million relating to these impaired loans, reflected in the recorded net fair value. Such amount is reflected as a non-accretable fair value adjustment to loans. The Company further estimated the timing and amount of expected cash flows in excess of the estimated fair value and established an accretable discount of \$329,000 on the acquisition date relating to these impaired loans.

The carrying value of the loans acquired and accounted for in accordance with ASC Subtopic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, was determined by projecting discounted contractual cash flows. The table below presents the components of the purchase accounting adjustments related to the purchased impaired loans acquired in the North Penn acquisition:

(In thousands)	2011	
Unpaid principal balance	\$	1,936
Interest		1,669
Contractual cash flows		3,605
Non-accretable discount		(1,724)
Expected cash flows		1,881
Accretable discount		(329)
Estimated fair value	\$	1,552

Changes in the accretable yield for purchased credit-impaired loans were as follows for the nine months ended September 30, 2011:

Balance at beginning of period	\$	329
Accretion		(40)
Reclassification and other		-
Balance at end of period	\$	289

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 probably 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.

A loan is considered to be a troubled debt restructuring ("TDR") loan when the Company grants a concession to the borrower because of the borrower's financial condition that it would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of principal or interest, or other modifications of interest rates that are less than the current market rate for new obligations with similar risk. TDR loans that are in compliance with their modified terms and that yield a market rate may be removed from the TDR status after a period of performance.

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 Loans	Consumer Loans	Total
	Residential	Commercial	Construction (In thousands)			
September 30, 2011						
Total Loans	\$ 148,925	\$ 256,964	\$ 11,486	\$ 23,343	\$ 14,524	\$ 455,242
Individually evaluated for impairment	\$-	\$ 14,174	\$ -	\$ 391	\$-	\$ 14,565
Loans acquired with deteriorated credit quality	-	780	-	-	-	780
Collectively evaluated for impairment	\$ 148,925	\$ 242,010	\$ 11,486	\$ 22,952	\$ 14,524	\$ 439,897
	Real Estate Loans			Commercial Loans	Consumer Loans	Total
	Residential	Commercial	Construction (In thousands)			
December 31, 2010						
Total Loans	\$ 124,562	\$ 184,094	\$ 12,638	\$ 22,386	\$ 13,668	\$ 357,348
Individually evaluated for impairment	\$-	\$ 14,239	\$ -	\$ 513	\$-	\$ 14,752
Collectively evaluated for impairment	\$ 124,562	\$ 169,855	\$ 12,638	\$ 21,873	\$ 13,668	\$ 342,596

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during the time within the period that the impaired loans were impaired.

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2011					
With no related allowance recorded:	(In thousands)				
Real Estate Loans					
Residential	\$-	\$-	\$-	\$-	\$-
Construction	-	-	-	-	-
Commercial	7,539	7,539	-	5,072	238
Commercial Loans	391	391	-	395	-
Consumer Loans	-	-	-	-	-
Total	7,930	7,930	-	5,467	238
With an allowance recorded:					
Real Estate Loans					
Residential	-	-	-	-	-
Construction	-	-	-	-	-
Commercial	7,415	7,415	1,322	10,382	142
Commercial Loans	-	-	-	-	-
Consumer Loans	-	-	-	-	-
Total	7,415	7,415	1,322	10,382	142
Total:					
Real Estate loans					
Residential	-	-	-	-	-
Construction	-	-	-	-	-
Commercial	14,954	14,954	1,322	15,454	380
Commercial Loans	391	391	-	395	-
Consumer Loans	-	-	-	-	-
Total Impaired Loans	\$15,345	\$15,345	\$1,322	\$15,849	\$380

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2010					
With no related allowance recorded:	(In thousands)				
Real Estate Loans					
Residential	\$-	\$-	\$-	\$-	\$-
Construction	-	-	-	-	-
Commercial	5,598	5,598	-	5,088	266
Commercial Loans	513	513	-	115	-
Consumer Loans	-	-	-	-	-
Total	6,111	6,111	-	5,203	266
With an allowance recorded:					
Real Estate Loans					
Residential	-	-	-	-	-
Construction	-	-	-	-	-
Commercial	8,641	8,548	1,648	4,734	119
Commercial Loans	-	-	-	159	-
Consumer Loans	-	-	-	-	-
Total	8,641	8,548	1,648	4,893	119
Total:					
Real Estate loans					
Residential	-	-	-	-	-
Construction	-	-	-	-	-
Commercial	14,239	14,146	1,648	9,822	385
Commercial Loans	513	513	-	274	-
Consumer Loans	-	-	-	-	-
Total Impaired Loans	\$14,752	\$14,659	\$1,648	\$10,096	\$385

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 September 30, 2011, troubled debt restructured loans totaled \$7.4 million and resulted in specific reserves of \$1.3 million. During 2011, there were no new loans identified as troubled debt restructurings. As of December 31, 2010, troubled debt restructured loans totaled \$7.6 million and resulted in specific reserves of \$1.5 million. During the first nine months of 2010, there were no loan modifications classified as troubled debt restructurings. The following table provides detail related to loans identified as troubled debt restructurings as of September 30, 2011:

	Number of Contracts (In thousands)	Modifications As of September 30, 2011	
		Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
Troubled Debt Restructuring Commercial	2	\$ 8,534	\$ 7,406
	Number of Contracts	Recorded Investment	
Troubled Debt Restructuring That Subsequently Defaulted Commercial	1	\$480	

Management uses a seven point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first three 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 Bank’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 \$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 September 30, 2011 and December 31, 2010 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
September 30, 2011						
Commercial real estate loans	\$ 230,028	\$ 8,209	\$ 18,727	\$-	\$-	\$ 256,964
Commercial loans	22,393	86	864	-	-	23,343
Total	\$ 252,421	\$ 8,295	\$ 19,591	\$-	\$-	\$ 280,307

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
December 31, 2010						
Commercial real estate loans	\$ 165,226	\$ 1,780	\$ 17,088	\$-	\$-	\$ 184,094
Commercial loans	21,759	75	552	-	-	22,386
Total	\$ 186,985	\$ 1,855	\$ 17,640	\$-	\$-	\$ 206,480

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 September 30, 2011 and December 31, 2010 (in thousands):

September 30, 2011	Performing	Nonperforming	Total
Residential real estate loans	\$ 147,132	\$ 1,793	\$ 148,925
Construction	11,486	-	11,486
Consumer loans	14,524	-	14,524
Total	\$ 173,142	\$ 1,793	\$ 174,935

December 31, 2010	Performing	Nonperforming	Total
Residential real estate loans	\$ 123,623	\$ 939	\$ 124,562
Construction	12,638	-	12,638
Consumer loans	13,668	-	13,668
Total	\$ 149,929	\$ 939	\$ 150,868

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 September 30, 2011 and December 31, 2010 (in thousands):

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
September 30, 2011							
Real Estate loans							
Residential	\$ 142,993	\$ 2,334	\$ 1,805	\$ -	\$ 1,793	\$ 5,932	\$ 148,925
Construction	11,445	35	6	-	-	41	11,486
Commercial	250,979	1,302	593	-	4,090	5,985	256,964
Commercial loans	22,952	-	-	-	391	391	23,343
Consumer loans	14,467	52	5	-	-	57	14,524
Total	\$ 442,836	\$ 3,723	\$ 2,409	\$ -	\$ 6,274	\$ 12,406	\$ 455,242

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
December 31, 2010							
Real Estate loans							
Residential	\$ 123,177	\$ 407	\$ -	\$ 39	\$ 939	\$ 1,385	\$ 124,562
Construction	12,622	16	-	-	-	16	12,638
Commercial	176,981	3,047	1,478	-	2,588	7,113	184,094
Commercial loans	21,858	15	-	-	513	528	22,386
Consumer loans	13,642	24	2	-	-	26	13,668
Total	\$ 348,280	\$ 3,509	\$ 1,480	\$ 39	\$ 4,040	\$ 9,068	\$ 357,348

The following table presents changes in the allowance for loan losses:

Three months ended September 30,		Nine months ended September 30,	
2011	2010	2011	2010
(In thousands)			

Edgar Filing: NORWOOD FINANCIAL CORP - Form 10-Q

Allowance balance at beginning of period	\$5,267	\$5,421	\$5,616	\$5,453
Charge-offs:	(384)	(166)	(1,417)	(690)
Recoveries:	37	8	71	20
Provision expense	425	250	1,075	730
Allowance balance at end of period	\$5,345	\$5,513	\$5,345	\$5,513

20

The following table presents the allowance for loan losses by the classes of the loan portfolio:

(In thousands)	Residential Real Estate	Commercial Real Estate	Construction	Commercial	Consumer	Total
Beginning balance, December 31, 2010	\$ 1,167	\$ 3,976	\$ 110	\$ 171	\$ 192	\$ 5,616
Charge Offs	(372)	(963)	-	(2)	(80)	(1,417)
Recoveries	25	-	-	5	41	71
Provision Expense	333	782	(29)	(20)	9	1,075
Ending balance, September 30, 2011	\$ 1,153	\$ 3,795	\$ 81	\$ 154	\$ 162	\$ 5,345
Ending balance individually evaluated for impairment	\$-	\$ 1,322	\$ -	\$ -	\$-	\$ 1,322
Ending balance collectively evaluated for impairment	\$ 1,153	\$ 2,473	\$ 81	\$ 154	\$ 162	\$ 4,023

The Company's primary business activity is with customers located in northeastern Pennsylvania. 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 September 30, 2011, the Company considered its concentration of credit risk to be acceptable. The highest concentrations are in the hospitality lodging industry, summer camps, and builders/contractors with loans outstanding of \$44.6 million, or 52.4% of capital, to the hospitality lodging industry; \$14.4 million, or 16.9% of capital, to summer camps; and \$13.0 million, or 15.2% of capital, to builders/contractors. During the third quarter, the Company recognized a write-down of \$198,000 on one motel loan that was previously carried in nonaccrual status and transferred the property to Foreclosed Real Estate Owned. There were no losses recognized on loans to builders/contractors or summer camps in 2011.

Gross realized gains and gross realized losses on sales of residential mortgage loans were \$240,000 and \$21,000 respectively, in the first nine months of 2011 compared to \$153,000 and \$14,000, respectively, in the same period in 2010. The proceeds from the sales of residential mortgage loans totaled \$9.0 million and \$10.7 million for the nine months ended September 30, 2011 and 2010, respectively.

9. Fair Value Measurements

Generally accepted accounting principles in the United States of America established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on 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 September 30, 2011 and December 31, 2010 are as follows:

Description	Fair Value Measurement Reporting Date Using			
	(Level 1) Quoted Prices in Active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs	
	Total (In thousands)			
September 30, 2011				
Available for Sale:				
US Government agencies	\$16,612	\$-	\$16,612	\$ -
States and political subdivisions	57,363	-	57,363	-
Corporate obligations	7,884	-	7,884	-
Mortgage-backed securities-government sponsored agencies	63,531	-	63,531	-
Equity securities-financial services	344	344	-	-
Total	\$145,734	\$344	\$145,390	\$ -
December 31, 2010				
Available for Sale:				
US Government agencies	\$30,268	\$-	\$30,268	\$ -
States and political subdivisions	49,766	-	49,766	-
Corporate obligations	4,249	-	4,249	-
Mortgage-backed securities-government sponsored agencies	60,928	-	60,928	-
Equity securities-financial services	604	604	-	--
Total	\$145,815	\$604	\$145,211	\$ -

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2011 and December 31, 2010 are as follows:

(In thousands)	Fair Value Measurement Reporting Date using	Reporting Date using		
		(Level 1) Quoted Prices in Active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Description	Total			
September 30, 2011				
Impaired Loans	\$ 14,023	\$ -	\$ -	\$ 14,023
Foreclosed Real Estate Owned	3,355	-	-	3,355
	\$ 17,378	\$ -	\$ -	\$ 17,378
December 31, 2010				
Impaired Loans	\$ 13,104	\$ -	\$ 7,038	\$ 6,066
Foreclosed Real Estate Owned	748	-	748	-
	\$ 13,852	\$ -	\$ 7,786	\$ 6,066

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 September 30, 2011 and December 31, 2010.

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) 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 2). 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):

The Company measured 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 expected proceeds. These assets are included as either Level 2 or Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. As of September 30, 2011, the fair value investment in impaired loans totaled \$15.3 million which includes 2 loans for \$7.4 million for which a valuation allowance has been provided based on current collateral values and 17 loans for \$7.9 million which do not require a valuation allowance since the current collateral value exceeds the loan value. As of September 30, 2011, the Company has recognized charge-offs against the allowance for loan losses on currently impaired loans in the amount of \$739,000 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.

Investment in Federal Home Loan Bank 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 restricted stock has no quoted market value and is carried at cost.

In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of excess capital stock. In October, 2010, the FHLB of Pittsburgh repurchased a portion of member bank's excess stock, but notified member banks that decisions regarding future capital stock repurchases will be made on a quarterly basis. Subsequent repurchases have been executed in each quarter of 2011.

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 believes no impairment charge is necessary related to FHLB stock as of September 30, 2011.

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):

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.

The estimated fair values of the Bank's financial instruments were as follows at September 30, 2011 and December 31, 2010.

	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Financial assets:				
Cash and due from banks, interest-bearing deposits with banks and federal funds sold	\$38,049	\$38,049	\$16,625	\$16,625
Securities	145,905	145,911	145,985	145,994
Loans receivable, net	449,487	457,631	351,239	358,873
Mortgage servicing rights	314	314	250	274
Investment in FHLB stock	3,782	3,782	3,361	3,361
Accrued interest receivable	2,758	2,758	2,166	2,166
Financial liabilities:				
Deposits	526,513	528,387	393,865	395,157
Short-term borrowings	31,976	31,976	33,309	33,309
Other borrowings	27,716	30,204	38,000	40,413
Accrued interest payable	1,489	1,489	1,536	1,536
Off-balance sheet financial instruments:				
Commitments to extend credit and outstanding letters of credit	-	-	-	-

10. New and Recently Adopted Accounting Pronouncements

In July 2010, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. ASU 2010-20 is intended to provide additional information to assist financial statement users in assessing an entity’s credit risk exposures and evaluating the adequacy of its allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The amendments in ASU 2010-20 encourage, but do not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption. The Company has provided the necessary disclosures in Note 8 herein.

In December, 2010, the Financial Accounting Standards Board (“FASB”) issued ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This ASU modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating an impairment may exist. The qualitative factors are consistent with the existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, the amendments in this Update are effective for fiscal year, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. This ASU is not expected to have a significant impact on the Company’s financial statements.

In December 2010, the FASB issued ASU 2010-29, Disclosure of Supplementary Pro Forma Information for Business Combinations. The amendments in this update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures under Topic 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments in this Update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. This ASU is not expected to have a significant impact on the Company’s financial statements.

In April 2011, the FASB issued ASU 2011-02, Receivables (Topic 310): A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The amendments in this Update provide additional guidance or clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The amendments in this Update are effective for the first interim or annual reporting period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company has provided the necessary disclosures in Note 8.

In April 2011, the FASB issued ASU 2011-03, Reconsideration of Effective Control for Repurchase Agreements. The main objective in developing this Update is to improve the accounting for repurchase agreements (repos) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this Update remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this Update apply to all entities, both public and nonpublic. The amendments affect all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The guidance in this Update is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. 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 June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income. The amendments in this Update improve the comparability, clarity, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS, the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. All entities that report items of comprehensive income, in any period presented, will be affected by the changes in this Update. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The amendments in this Update should be applied retrospectively, and early adoption is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In September 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other Topics (Topic 350), Testing Goodwill for Impairment. The objective of this update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this Update apply to all entities, both public and nonpublic, that have goodwill reported in their financial statements and are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for

annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. This ASU is not expected to have a significant impact on the Company's financial statements.

11. Acquisition of North Penn Bancorp, Inc.

On May 31, 2011, the Company closed on a merger transaction pursuant to which Norwood Financial Corp acquired North Penn Bancorp, Inc. in a stock and cash transaction. The acquisition was an in-market transaction that expanded the Company's existing footprint in Monroe County, Pennsylvania and extended its footprint into Lackawanna County, Pennsylvania.

North Penn Bancorp, Inc. was the holding company for North Penn Bank, a Pennsylvania savings bank that conducted its business from a main office in Scranton, Pennsylvania and four branch offices in the northeastern Pennsylvania counties of Lackawanna and Monroe.

Under the terms of the merger agreement, the Company acquired all of the outstanding shares of North Penn Bancorp, Inc. for a total purchase price of approximately \$25.4 million. North Penn Bank has been merged into Wayne Bank, with Wayne as the surviving entity.

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 (including borrower financial statements or tax returns), appraised collateral values, expected cash flows and historical loss factors of North Penn Bank. Real estate acquired through foreclosure was primarily valued based on appraised collateral values. The Company also recorded an identifiable intangible asset representing the core deposit base of North Penn Bank 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 fair value investment securities and FHLB advances.

The business combination resulted in the acquisition of loans with and without evidence of credit quality deterioration. North Penn Bank's 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 nonaccretable difference. At the acquisition date, the Company recorded \$1.9 million of purchased credit-impaired loans subject to a nonaccretable difference of \$1.7 million. 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.

North Penn Bank'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, North Penn's loan portfolio without evidence of deterioration totaled \$119.8 million and was recorded at a fair value of \$116.7 million.

The following table summarizes the purchase of North Penn Bancorp, Inc. as of May 31, 2011:

(\$ In thousands except per share data)

Purchase Price Consideration in Common Stock (1)		
North Penn common shares settled for stock	777,927	
Exchange Ratio	0.6829	
Norwood shares issued	531,246	
Value assigned to Norwood common share	\$27.76	
Purchase price assigned to North Penn common shares exchanged for Norwood stock		\$14,748
Purchase Price Consideration-Cash for Common Stock (1)		
North Penn shares exchanged for cash	471,446	
Purchase price paid to each North Penn common share exchanged for cash	\$19.12	
Purchase price assigned to North Penn common shares exchanged for cash		9,014
Purchase Price Consideration-Cash for Unallocated ESOP Shares (1)		
North Penn Unallocated ESOP Shares Outstanding	85,471	
Unallocated ESOP Shares settlement price per share	\$19.12	
Purchase price assigned to North Penn unallocated ESOP shares settled for cash		1,634
Total Purchase Price		25,396
Net Assets Acquired:		
North Penn shareholders' equity	\$18,195	
North Penn goodwill and intangibles	-	
Adjustments to reflect assets acquired at fair value:		
Investments	-	
Loans	(3,525))
Allowance for loan losses	1,570	
Core deposit intangible	895	
Premises & equipment	(783))
Deferred tax assets	1,152	
Adjustments to reflect liabilities acquired at fair value:		
Time deposits	(815))
Borrowings	(776))
		15,913
Goodwill resulting from merger		\$9,483

The following condensed statement reflects the values assigned to North Penn Bancorp's net assets as of the acquisition date:

Total purchase price		\$25,396
Net Assets Acquired:		
Cash	\$15,192	
Securities held to maturity	-	
Securities available for sale	12,671	
Restricted investments	985	
Loans	118,336	
Accrued interest receivable	566	
Premises & equipment, net	2,931	
Core deposit intangible	895	
Deferred tax assets	2,947	
Other assets	5,403	
Time deposits	(51,936)
Deposits other than time deposits	(83,498)
Borrowings	(7,776)
Accrued interest payable	(203)
Other liabilities	(600)
		15,913
Goodwill resulting from North Penn Merger		\$9,483

The Company recorded goodwill and other intangibles associated with the purchase of North Penn Bancorp, Inc. totaling \$10.4 million. Goodwill is not amortized, but is periodically evaluated for impairment. The Company did not recognize any impairment during the quarter ended September 30, 2011. The carrying amount of the goodwill at September 30, 2011 was \$9.5 million.

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 quarter ended September 30, 2011, no such adjustments were recorded. The identifiable intangible asset consists of a core deposit intangible which is being amortized on an accelerated basis over the useful life of such asset. The gross carrying amount of the core deposit intangible at September 30, 2011 was \$895,000 with \$55,000 accumulated amortization as of that date.

As of September 30, 2011, the current year and estimated future amortization expense for the core deposit intangible was:

2011	\$ 95,000
2012	153,000
2013	137,000
2014	121,000
2015	104,000
2016	88,000
2017	72,000
2018	56,000
2019	39,000
2020	23,000
2021	7,000

\$ 895,000

Results of operations for North Penn prior to the acquisition date are not included in the Consolidated Statement of Income for the three and nine month periods ended September 30, 2011. Due to the significant amount of fair value adjustments historical results of North Penn are not relevant to the Company's results of operations. Therefore, no pro forma information is presented.

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 are as follows:

- our ability to realize the anticipated benefits from our acquisition of North Penn Bancorp, Inc.
- 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
- higher deposit insurance premiums
- soundness of other financial institutions
- increased compliance burden under new financial reform legislation
- risk of failure to stabilize the financial system
- current market volatility
- potential liquidity risk
- availability of capital
- regional economic factors
- loss of senior officers
- comparatively low legal lending limits
- limited market for the Company's stock
- restrictions on ability to pay dividends
- common stock may lose value
- competitive environment
- issuing additional shares may dilute ownership
- extensive and complex governmental regulation and associated cost
- interest rate risks

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, 2010 (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

31

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, potential impairment of restricted stock, accounting for stock options, the valuation of deferred tax assets, the fair value of financial instruments, valuation of impaired loans, and the determination of other-than-temporary impairment losses on securities. Please refer to the discussion of the allowance for loan losses calculation under “Allowance for Loan Losses and Non-performing Assets” in the “Changes in Financial Condition” section.

The Company uses the modified prospective transition method to account for stock based compensation. Under this method companies are required to record compensation expense, based on the fair value of options over the vesting period.

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.

Restricted stock which represents required investment in the common stock of correspondent banks is carried at cost and as of September 30, 2011 and December 31, 2010, consists of the common stock of the Federal Home Loan Bank of Pittsburgh. In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of excess capital stock. In October, 2010, the FHLB of Pittsburgh repurchased a portion of member bank’s excess stock, but notified member banks that decisions regarding future capital stock repurchases will be made on a quarterly basis. Subsequent stock repurchases have been executed in each quarter since October 2010.

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 decline 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 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 believes no impairment charge is necessary related to the restricted stock as of September 30, 2011 and December 31, 2010.

In estimating other-than-temporary impairment losses on securities, the Company considers 1) the length of time and extent to which the fair value has been less than cost, 2) the financial condition of the issuer, and 3) the intent and ability of the Company to hold the security to allow for a recovery to fair value. The Company believes that the unrealized loss on all other securities at September 30, 2011 and December 31, 2010 represent temporary impairment of the securities, related to changes in interest rates.

In connection with the acquisition of North Penn, we recorded goodwill in the amount of \$9.5 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 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 September 30, 2011 were \$678.9 million compared to \$537.0 million as of December 31, 2010, an increase of \$141.9 million. The increase includes \$168.3 million of assets acquired as a result of the North Penn transaction.

Securities

The fair value of securities available for sale as of September 30, 2011 was \$145.7 million compared to \$145.8 million as of December 31, 2010. The Company purchased \$35.0 million of securities principally using the proceeds from \$50.9 million of securities sold, called, maturities and principal reductions. Additionally, the Company acquired \$12.6 million of securities in the North Penn transaction.

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

(dollars in thousands)	September 30, 2011		December 31, 2010		
	Amount	% of portfolio	Amount	% of portfolio	
US Government agencies	\$16,612	11.4	% \$30,268	20.7	%
States and political subdivisions	57,534	39.4	49,936	34.2	
Corporate obligations	7,884	5.4	4,249	2.9	
Mortgage-backed securities-					
government sponsored entities	63,531	43.6	60,928	41.8	
Equity securities-financial services	344	0.2	604	0.4	
Total	\$145,905	100.0	% \$145,985	100.0	%

The Company has securities in an unrealized loss position. In management's opinion, the unrealized losses in state and political subdivisions, corporate obligations and mortgage-backed securities reflect changes in interest rates subsequent to the acquisition of specific securities. The Company holds a small amount of equity securities in other financial institutions, the value of which has been impacted by the weakening conditions of the financial markets. Management believes that the unrealized losses on all other equity 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 \$454.8 million at September 30, 2011 compared to \$356.9 million as of December 31, 2010. The majority of the growth recorded in 2011 is a result of the acquisition of North Penn Bancorp. Residential real estate loans increased \$24.4 million after the sale of \$8.7 million of residential mortgages. The loans were sold for interest rate risk management to shorten the average life of the mortgage loan portfolio. Commercial loans including commercial real estate loans increased \$73.8 million during the period.

The allowance for loan losses totaled \$5,345,000 as of September 30, 2011 and represented 1.18% of total loans, compared to \$5,616,000 at December 31, 2010, and \$5,513,000 as of September 30, 2010. The Company had net charge-offs for the nine months ended September 30, 2011 of \$1,346,000 compared to \$670,000 in the comparable period in 2010. The Company's loan review process 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, large dollar exposures and loan growth. Management considers the allowance adequate at September 30, 2011 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 September 30, 2011, non-performing loans totaled \$6.3 million, which is 1.38% of total loans compared to \$4,079,000, or 1.14% of total loans at December 31, 2010. The increase was principally due to the acquisition of \$2.0 million of non-performing loans from North Penn.

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

(dollars in thousands)	September 30, 2011	December 31, 2010
Loans accounted for on a non-accrual basis:		
Commercial and all other	\$ 391	\$ 513
Real Estate	5,883	3,527
Consumer	-	-
Total	6,274	4,040
Accruing loans which are contractually past due 90 days or more	-	39
Total non-performing loans	6,274	4,079
Foreclosed real estate	3,355	748
Total non-performing assets	\$ 9,629	\$ 4,827
Allowance for loans losses	5,345	5,616
Coverage of non-performing loans	.85x	\$ 1.38x
Non-performing loans to total loans	1.38 %	1.14 %
Non-performing loans to total assets	.92 %	.76 %
Non-performing assets to total assets	1.42 %	.90 %

Deposits

During the period, total deposits increased \$132.6 million which includes growth of \$135.4 million due to the North Penn acquisition. Other variances include a \$7.7 million increase in non-interest bearing demand deposits, a \$20.0 million increase in money market and NOW accounts, and a \$28.0 million decrease in savings deposits. The fluctuations between money market and savings balances are due to internal migration resulting from the merger. Certificates of deposit declined \$17.9 million due primarily to the seasonality of jumbo certificates and transfers to more liquid accounts.

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

(dollars in thousands)	September 30, 2011	December 31, 2010
Non-interest bearing demand	\$ 78,500	\$ 62,238
Interest bearing demand	53,216	38,168
Money market deposit accounts	119,002	70,812
Savings	69,651	50,341
Time deposits <\$100,000	142,582	112,291
Time deposits >\$100,000	63,562	60,015
Total	\$ 526,513	\$ 393,865

Borrowings

Short-term borrowings as of September 30, 2011 totaled \$32.0 million compared to \$33.3 million as of December 31, 2010. Securities sold under agreements to repurchase declined \$1.3 million principally due to the seasonality of municipal cash management accounts. Short-term borrowings consist of the following:

(dollars in thousands)	September 30, 2011	December 31, 2010
Securities sold under agreements to repurchase	\$ 31,779	\$ 33,110
U.S. Treasury demand notes	197	199
	\$ 31,976	\$ 33,309

Other borrowings consisted of the following:

(dollars in thousands)	September 30, 2011	December 31, 2010
Notes with the FHLB:		
Convertible note due January 2011 at 5.24%	\$ -	\$ 3,000
Convertible note due August 2011 at 2.69%	-	10,000
Fixed rate note due September 2011 at 4.06%	-	5,000
Convertible note due October 2012 at 4.37%	5,000	5,000
Convertible note due May 2013 at 3.015%	5,000	5,000
Fixed rate note due July 2015 at 4.34%	7,716	-
Convertible note due January 2017 at 4.71%	10,000	10,000
	\$ 27,716	\$ 38,000

The convertible notes contain an option which allows the FHLB, at quarterly intervals to change the note to an adjustable-rate advance at three month LIBOR plus 11 to 19 basis points. If the notes are converted, the option allows the Bank to put the funds back to the FHLB at no charge. The fixed rate borrowing due July 2015 includes a \$716,000 fair value adjustment recorded at the time of the acquisition.

Off-Balance Sheet Arrangements

The Bank is 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 sheet.

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. Commitments to grant loans totaled \$37.6 million as of September 30, 2011 compared to \$21.4 million as of December 31, 2010. The increase is due to commercial real estate transactions and the North Penn acquisition.

A summary of the contractual amount of the Company's financial instrument commitments is as follows:

	September 30, 2011 (in thousands)	December 31, 2010
Commitments to grant loans	\$ 37,649	\$ 21,448
Unfunded commitments under lines of credit	31,183	30,311
Standby letters of credit	11,960	3,605
	\$ 80,792	\$ 55,364

Stockholders' Equity and Capital Ratios

As of September 30, 2011, stockholders' equity totaled \$86.9 million, compared to \$67.7 million as of December 31, 2010. The net change in stockholders' equity included \$5.4 million of net income, that was partially offset by \$2.7 million of dividends declared and a \$200,000 reduction due to an increase in Treasury Stock. Total equity also increased \$14.7 million due to the issuance of common stock in the North Penn transaction. In addition, accumulated other comprehensive income increased \$1.9 million due to an increase in 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 could materially fluctuate for each interim and year-end period.

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

	September 30, 2011	December 31, 2010
Tier 1 Capital (To average assets)	10.91%	12.41%
Tier 1 Capital (To risk-weighted assets)	15.81%	18.44%
Total Capital (To risk-weighted assets)	16.97%	19.74%

The minimum capital requirements imposed by the FDIC on the Bank for leverage, Tier 1 and Total Capital are 4%, 4% and 8%, respectively. The Company has similar capital requirements imposed by the Board of Governors of the Federal Reserve System (FRB). The Bank is also subject to more stringent Pennsylvania Department of Banking (PDB) guidelines. The Bank's capital ratios do not differ significantly from the Company's ratios. Although not adopted in regulation form, the PDB utilizes capital standards requiring a minimum of 6.5% leverage capital and 10% total capital. The Company and the Bank were in compliance with FRB, FDIC and PDB capital requirements as of September 30, 2011 and December 31, 2010.

Liquidity

As of September 30, 2011, the Company had cash and cash equivalents of \$38.1 million in the form of cash, due from banks, Federal Funds sold and short-term deposits with other institutions. In addition, the Company had total securities available for sale of \$145.7 million which could be used for liquidity needs. This totals \$183.8 million and represents 27.1% of total assets compared to \$162.4 million and 30.2% of total assets as of December 31, 2010. The Company also monitors other liquidity measures, all of which were within the Company's policy guidelines as of September 30, 2011 and December 31, 2010. Based upon these measures, the Company believes its liquidity is adequate.

Capital Resources

The Company has a line of credit commitment available from the Federal Home Loan Bank (FHLB) of Pittsburgh for borrowings of up to \$20,000,000 which expires in December 2011. There were no borrowings under this line at September 30, 2011 and December 31, 2010.

The Company has a line of credit commitment from Atlantic Central Bankers Bank for \$7,000,000 which expires June 30, 2012. There were no borrowings under this line as of September 30, 2011 and December 31, 2010.

The Company has a line of credit commitment available which has no stated expiration date from PNC Bank for \$16,000,000. Borrowings under this line were \$-0- as of June 30, 2011 and December 31, 2010.

The Bank's maximum borrowing capacity with the Federal Home Loan Bank was approximately \$208,000,000 as of September 30, 2011, of which \$27,000,000 and \$38,000,000 was outstanding at September 30, 2011 and December 31, 2010 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 38 and 42. 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.

Results of Operations

NORWOOD FINANCIAL CORP.

Consolidated Average Balance Sheets with Resultant Interest and Rates

(Tax-Equivalent Basis, dollars

in thousands)

	Three Months Ended September 30,					
	2011			2010		
	Average Balance (2)	Interest (1)	Average Rate (3)	Average Balance (2)	Interest (1)	Average Rate (3)
Assets						
Interest-earning assets:						
Federal funds sold	\$ 1,416	\$ -	0.04 %	\$ 3,000	\$ 2	0.27 %
Interest bearing deposits with banks	26,627	18	0.27	16,529	12	0.29
Securities held-to-maturity	170	3	7.06	169	3	7.10
Securities available for sale:						
Taxable	94,973	626	2.64	96,562	687	2.85
Tax-exempt(1)	52,824	740	5.60	44,583	646	5.80
Total securities available for sale (1)	147,797	1,366	3.70	141,145	1,333	3.78
Loans receivable (1) (4) (5)	460,450	6,578	5.71	353,953	5,318	6.01
Total interest earning assets	636,460	7,965	5.01	514,796	6,668	5.18
Non-interest earning assets:						
Cash and due from banks	10,120			7,642		
Allowance for loan losses	(5,358)			(5,481)		
Other assets	46,985			23,261		
Total non-interest earning assets	51,747			25,422		
Total Assets	\$ 688,207			\$ 540,218		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest bearing demand and money market	\$ 160,344	165	0.41	\$ 115,553	152	0.53
Savings	84,062	61	0.29	49,759	27	0.22
Time	209,106	828	1.58	171,240	852	1.99
Total interest bearing deposits	453,512	1,054	0.93	336,552	1,031	1.23
Short-term borrowings	28,956	24	0.33	23,933	26	0.43
Other borrowings	38,285	314	3.28	42,891	419	3.92
Total interest bearing liabilities	520,753	1,392	1.07	403,376	1,476	1.46
Non-interest bearing liabilities:						
Demand deposits	75,831			64,512		
Other liabilities	5,204			5,508		
	81,035			70,020		

Total non-interest bearing
liabilities

Stockholders' equity	86,419		66,822	
Total Liabilities and Stockholders' Equity	\$ 688,207		\$ 540,218	

Net interest income (tax equivalent basis)	6,573	3.94 %	5,192	3.72 %
Tax-equivalent basis adjustment	(310)		(273)	
Net interest income	\$ 6,263		\$ 4,919	
Net interest margin (tax equivalent basis)		4.13 %		4.03 %

- (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)		
	Three months ended September 30, 2011		
	Compared to		
	Three months ended September 30, 2010		
	Variance due to		
	Volume	Rate	Net
	(dollars in thousands)		
Interest earning assets:			
Federal funds sold	\$(1	) \$(1	) \$(2
Interest bearing deposits with banks	11	(5	) 6
Securities held to maturity	-	-	-
Securities available for sale:			
Taxable	(11	) (50	) (61
Tax-exempt securities	225	(131	) 94
Total securities	214	(181	) 33
Loans receivable	2,885	(1,626	) 1,259
Total interest earning assets	3,109	(1,813	) 1,296
Interest bearing liabilities:			
Interest-bearing demand and money market....	178	(165	) 13
Savings	23	11	34
Time	711	(735	) (24
Total interest bearing deposits	912	(889	) 23
Short-term borrowings	22	(24	) (2
Other borrowings	(42	) (64	) (106
Total interest bearing liabilities	892	977	(85
Net interest income (tax-equivalent basis)	\$2,217	\$(836	) \$1,381

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 September 30, 2011 to September 30, 2010

General

For the three months ended September 30, 2011, net income totaled \$2,215,000 compared to \$1,890,000 earned in the similar period in 2010. The increased net income for the three months ended September 30, 2011 reflects the full-quarter impact of the acquisition of North Penn Bancorp, Inc. (“North Penn”), which was completed on May 31, 2011. Earnings per share for the current period were \$.67 for basic and fully diluted compared to \$.68 per share for the three months ended September 30, 2010. The decrease in earnings per share for the three months ended September 30, 2011 reflects the increase in outstanding shares resulting from the North Penn acquisition. The resulting annualized return on average assets and annualized return on average equity for the three months ended September 30, 2011 was 1.28% and 10.17%, respectively, compared to 1.39% and 10.98%, respectively, for the similar period in 2010.

The following table sets forth changes in net income:

(dollars in thousands)	Three months ended September 30, 2011 to September 30, 2010	
Net income three months ended September 30, 2010	\$	1,890
Change due to:		
Net interest income		1,344
Provision for loan losses		(175)
Gain on sales of loans and securities		421
Other income		50
Salaries and employee benefits		(472)
Occupancy, furniture and equipment		(101)
Foreclosed real estate expense		(369)
All other expenses		(300)
Income tax expense		(73)
Net income three months ended September 30, 2011	\$	2,215

Net Interest Income

Net interest income on a fully taxable equivalent basis (fte) for the three months ended September 30, 2011, totaled \$6,573,000, an increase of \$1,381,000 or 26.6% from the similar period in 2010. The increase in net interest income largely reflects the increase in interest-earning assets from the North Penn acquisition. The fte net interest spread and net interest margin were 3.94% and 4.13%, respectively, for the three months ended September 30, 2011 compared to 3.72% and 4.03%, respectively, for the similar period in 2010.

Interest income (fte) totaled \$7,965,000 with a yield on average earning assets of 5.01% compared to \$6,668,000 and 5.18% for the 2010 period. The decrease in yield was due to a 30 basis point decrease in loan yields due to growth at current market rates and a higher level of nonperforming assets, combined with the reinvestment of securities cash flow and new purchases of securities at lower than historical rates. The yields earned on tax-free securities were also lower than the same three months of 2010. An increased level of low yielding money market assets also contributed to the decreased yield. Average earning assets totaled \$636.5 million for the three months ended September 30, 2011, an increase of \$121.7 million over the average for the similar period in 2010. This increase in average earning assets helped offset the decline in asset yields.

Interest expense for the three months ended September 30, 2011 totaled \$1,392,000 at an average cost of 1.07% compared to \$1,476,000 and 1.46% for the similar period in 2010. As a result of the continued low interest rate environment, the Company further reduced rates paid on its money market accounts and cash management products, which are included in short-term borrowings. The cost of time deposits, which is the most significant component of funding, declined to 1.58% from 1.99% for the similar period in the prior year. As time deposits matured, they repriced at the current lower rates resulting in the decrease.

Provision for Loan Losses

The Company's provision for loan losses for the three months ended September 30, 2011 was \$425,000 compared to \$250,000 for the three months ended September 30, 2010. The Company makes provisions for loan losses in an amount necessary to maintain the allowance for loan losses at an acceptable level. The increase in the provision reflects an increase in net charge-offs during the quarter. Net charge-offs were \$347,000 for the quarter ended September 30, 2011 compared to \$158,000 for the similar period in 2010.

Other Income

Other income totaled \$1,506,000 for the three months ended September 30, 2011 compared to \$1,035,000 for the similar period in 2010. The current period includes a \$544,000 gain on the sale of investment securities compared to a \$161,000 gain in the third quarter of 2010. All other service charges and fees increased \$88,000 compared to the third quarter of last year including a \$38,000 increase in gains on the sale of residential mortgage loans.

Other Expense

Other expense for the three months ended September 30, 2011 totaled \$4,354,000, or an increase of \$1,242,000 from \$3,112,000 for the similar period in 2010. Expense increases related to the North Penn acquisition including staffing increases and higher occupancy costs contributed to the increase. Foreclosed real estate costs also increased \$369,000 due to the costs of disposition and maintaining several properties.

Income Tax Expense

Income tax expense totaled \$775,000 for an effective tax rate of 25.6% for the period ending September 30, 2011 compared to \$702,000 for an effective tax rate of 27.0% for the similar period in 2010 due primarily to the \$8.2 million increase in average tax-exempt securities.

Results of Operations

NORWOOD FINANCIAL CORP.

Consolidated Average Balance Sheets with Resultant Interest and Rates

(Tax-Equivalent Basis, dollars

in thousands)

	Nine Months Ended September 30,					
	2011			2010		
	Average Balance (2)	Interest (1)	Average Rate (3)	Average Balance (2)	Interest (1)	Average Rate (3)
Assets						
Interest-earning assets:						
Federal funds sold	\$ 737	\$ -	0.07 %	\$ 3,000	\$ 7	0.31 %
Interest bearing deposits with banks	20,834	42	0.27	16,712	36	0.29
Securities held-to-maturity(1)	170	10	7.84	317	20	8.41
Securities available for sale:						
Taxable	98,131	1,971	2.68	96,307	2,372	3.28
Tax-exempt(1)	48,790	2,066	5.65	37,821	1,655	5.83
Total securities available for sale (1)	146,921	4,037	3.66	134,128	4,027	4.00
Loans receivable (4) (5)	400,650	17,065	5.68	355,368	16,037	6.02
Total interest earning assets	569,312	21,154	4.95	509,525	20,127	5.27
Non-interest earning assets:						
Cash and due from banks	8,132			7,235		
Allowance for loan losses	(5,616)			(5,445)		
Other assets	33,978			22,190		
Total non-interest earning assets	36,494			23,980		
Total Assets	\$ 605,806			\$ 533,505		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest bearing demand and money market	\$ 131,968	405	0.41	\$ 106,993	449	0.56
Savings	68,124	139	0.27	48,260	84	0.23
Time	189,301	2,327	1.64	179,546	2,799	2.08
Total interest bearing deposits	389,393	2,871	0.98	334,799	3,332	1.33
Short-term borrowings	29,140	75	0.34	23,790	87	0.49
Other borrowings	37,160	992	3.56	42,963	1,247	3.87
Total interest bearing liabilities	455,693	3,938	1.15	401,552	4,666	1.55
Non-interest bearing liabilities:						
Demand deposits	68,588			61,819		
Other liabilities	4,902			5,012		
Total non-interest bearing liabilities	73,490			66,831		

Edgar Filing: NORWOOD FINANCIAL CORP - Form 10-Q

Stockholders' equity	76,623	65,122
Total Liabilities and Stockholders' Equity	\$ 605,806	\$ 533,505

Net interest income (tax equivalent basis)	17,216	3.80 %	15,461	3.72 %
Tax-equivalent basis adjustment	(854)		(713)	
Net interest income	\$ 16,362		\$ 14,748	
Net interest margin (tax equivalent basis)		4.03 %		4.05 %

- (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. 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.

	Increase/(Decrease)		
	Nine Months Ended September 30, 2011		
	Compared to		
	Nine Months Ended September 30, 2010		
	Variance due to		
	Volume	Rate	Net
	(dollars in thousands)		
Interest earning assets:			
Federal funds sold	\$ (4)	\$ (3)	\$ (7)
Interest bearing deposits with banks	10	(4)	6
Securities held to maturity	(9)	(1)	(10)
Securities available for sale:			
Taxable	71	(472)	(401)
Tax-exempt securities	498	(87)	411
Total securities	569	(559)	10
Loans receivable	2,381	(1,353)	1,028
Total interest earning assets	2,947	(1,920)	1,027
Interest bearing liabilities:			
Interest-bearing demand and money market			
Savings	39	16	55
Time	226	(698)	(472)
Total interest bearing deposits	394	(855)	(461)
Short-term borrowings			
Other borrowings	(160)	(95)	(255)
Total interest bearing liabilities	258	(986)	(728)
Net interest income (tax-equivalent basis)	\$2,689	\$ (934)	\$1,755

Comparison of Operating Results for Nine Months Ended September 30, 2011 and September 30, 2010

General

For the nine months ended September 30, 2011, net income totaled \$5,359,000 compared to \$5,505,000 earned in the similar period of 2010. The increase in net income was primarily driven by the North Penn acquisition which increased average interest-earning assets and net interest income. Earnings per share for the current period were \$1.79 per share for both basic and diluted per share compared to \$1.99 per share for the nine months ended September 30, 2010. The increase in the number of shares resulting from the North Penn acquisition contributed to the decrease in earnings per share. The resulting annualized return on average assets and annualized return on average equity for the nine months ended September 30, 2011 was 1.18% and 9.35% and 1.38% and 11.04%, respectively, for the similar period in 2010.

The following table sets forth changes in net income:

(dollars in thousands)	Nine Months Ended September 30, 2011 to September 30, 2010	
Net income nine months ended September 30, 2010	\$	5,505
Change due to:		
Net interest income		1,614
Provision for loan losses		(345)
Gain on sales of loans and securities		462
Other income		192
Salaries and employee benefits		(818)
Occupancy, furniture and equipment expense, net		(105)
Merger related expenses		(771)
Foreclosed real estate costs		(376)
All other expenses		(306)
Income tax expense		307
Net income nine months ended September 30, 2011	\$	5,359

Net Interest Income

Net interest income on a fully taxable equivalent basis (fte) for the nine months ended September 30, 2011 totaled \$17,216,000, an increase of \$1,755,000, or 11.3% over the similar period in 2010. The fte net interest spread and net interest margin were 3.80% and 4.03% respectively, compared to 3.72% and 4.05% respectively for the similar period in 2010.

Interest income (fte) totaled \$21,154,000 with a yield on average earning assets of 4.95% compared to \$20,127,000 and 5.27% for the similar period in 2010. Residential mortgage rates continue to decline causing a portion of the portfolio to refinance at lower rates, while other loan growth at current market rates has also contributed to the decrease in portfolio yield. As a result, the fte yield on average loans in the current period was 5.68% down from 6.02% in the 2010 period. The yield on investment securities also declined 34 basis points reflecting the reinvestment of cash flow, maturities and calls at the current lower rate. Average earning assets totaled \$569.3 million for the nine months ended September 30, 2011 an increase of \$59.8 million over the similar period in 2010. The growth in average earning assets helped offset the decline in asset yields.

Interest expense for the nine months ended September 30, 2011 totaled \$3,938,000 with an average cost of 1.15% compared to \$4,666,000 and 1.55% for the 2010 period. The Company reduced rates paid on its deposits by 35 basis points and short-term borrowings by 15 basis points. The cost of time deposits which is the largest component of interest expense was 1.64% for the 2011 period decreasing from 2.08% in 2010. This reflects time deposits maturing and repricing at the current lower rates.

Provision for Loan Losses

The Company's provision for loan losses for the nine months ended September 30, 2011 was \$1,075,000 compared to \$730,000 for the nine months ended September 30, 2010. The Company makes provisions for loan

losses in an amount necessary to maintain the allowance for loan losses at an acceptable level. The increase in the provision reflects an increase in net charge-offs during the nine months ended September 30, 2011. Net charge-offs were \$1.3 million for the nine months ended September 30, 2011 compared to \$670,000 for the similar period in 2010. The increase in charge-offs during the 2011 period is due primarily to one credit which had been carried in nonaccrual status.

Other Income

Other income totaled \$3,707,000 for the nine months ended September 30, 2011 compared to \$3,053,000 for the similar period in 2010. The current period includes \$282,000 in gains on the sale of \$8.7 million of residential mortgage loans compared to \$208,000 in similar gains on the sales of \$10.5 million of mortgage loans in the 2010 period. Gains on the sale investment securities totaled \$768,000 on sales of \$27.7 million for the 2011 period compared to \$380,000 of gains on sales of \$23.7 million in the similar 2010 period. The proceeds from investment securities sales were reinvested to improve credit quality in the Company's municipal bond portfolio and to enhance current and future income through coupon payments and cash flow.

Other Expenses

Other expense totaled \$11,824,000 for the nine months ended September 30, 2011, an increase of \$2,376,000 compared to \$9,448,000 for the similar period in 2010. The majority of the increase was due to the acquisition of North Penn, including employment costs and occupancy expenses of five new community offices. An additional \$721,000 of merger related costs were incurred in 2011. Salary and benefit costs also increased due to new hires and merit increases. The efficiency ratio for the 2011 period was 56.5% compared to 50.4% in the 2010 period due to the acquisition costs recorded in 2011.

Income Tax Expense

Income tax expense totaled \$1,811,000 for an effective tax rate of 25.3% in the 2011 period compared to \$2,118,000 and 27.8% in 2010. The decrease in the effective tax rate was principally due to a higher level of tax-exempt income related to purchases of municipal obligations held in the available-for-sale portfolio.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Risk

Interest rate sensitivity and the repricing characteristics of assets and liabilities are managed by the Asset and Liability Management Committee (ALCO). The principal objective of ALCO is to maximize net interest income within acceptable levels of risk, which are established by policy. Interest rate risk is monitored and managed by using financial modeling techniques to measure the impact of changes in interest rates.

Net interest income, which is the primary source of the Company's earnings, is impacted by changes in interest rates and the relationship of different interest rates. To manage the impact of the rate changes, the balance sheet must be structured so that repricing opportunities exist for both assets and liabilities at approximately the same time intervals. The Company uses net interest simulation to assist in interest rate risk management. The process includes simulating various interest rate environments and their impact on net interest income. As of September 30, 2011, the level of net interest income at risk in a 200 basis point change in interest rates was within the Company's policy limits. The Company's policy allows for a decline of no more than 8% of net interest income for a \pm 200 basis point shift in interest rates.

Imbalance in repricing opportunities at a given point in time reflects interest-sensitivity gaps measured as the difference between rate-sensitive assets (RSA) and rate-sensitive liabilities (RSL). These are static gap measurements that do not take into account any future activity, and as such are principally used as early indications of potential interest rate exposures over specific intervals.

As of September 30, 2011, the Company had a positive 90 day interest sensitivity gap of \$77.9 million or 11.5% of total assets, an increase from the \$41.3 million or 7.7% of total assets as of December 31, 2010. Rate sensitive assets repricing within 90 days increased \$56.7 million due primarily to loans acquired and a higher level of overnight liquidity. Time deposits repricing within 90 days increased \$9.4 million, while non-maturity interest bearing balances increased \$13.9 million due primarily to the acquisition. Other borrowings decreased \$3.2 million due to a net reduction in Federal Home Loan Bank advances. A positive gap means that rate-sensitive assets are greater than rate-sensitive liabilities at the time interval. This would indicate that in a rising rate environment, the yield on interest-earning assets could increase faster than the cost of interest-bearing liabilities in the 90 day time frame. The repricing intervals are managed by ALCO strategies, including adjusting the average life of the investment portfolio, pricing of deposit liabilities to attract longer term time deposits, loan pricing to encourage variable rate products and evaluation of loan sales of long-term fixed rate mortgages.

September 30, 2011
Rate Sensitivity Table
(dollars in thousands)

	3 Months	3-12 Months	1 to 3 Years	Over 3 Years	Total
Federal funds sold and interest bearing deposits	\$25,577	\$-	\$-	\$-	\$25,577
Securities	14,019	24,900	44,996	61,990	145,905
Loans Receivable	124,154	86,308	154,585	89,785	454,832
Total RSA	163,750	111,208	199,581	151,775	626,314
Non-maturity interest-bearing deposits	39,128	43,320	115,420	44,001	241,869
Time Deposits	39,381	71,990	67,370	27,403	206,144
Other	7,359	10,722	23,895	17,716	59,692
Total RSL	85,868	126,032	206,685	89,120	507,705
Interest Sensitivity Gap	\$77,882	\$(14,824)	\$(7,104)	\$62,655	\$118,609
Cumulative Gap	77,882	63,058	55,954	118,609	
RSA/RSL-cumulative	210.2	% 129.8	% 113.4	% 123.4	%

December 31, 2010

Interest Sensitivity Gap	\$41,341	\$(33,613)	\$10,969	\$92,050	\$110,747
Cumulative Gap	41,341	7,728	18,697	110,747	
RSA/RSL-cumulative	162.9	% 103.9	% 105.5	% 127.5	%

Item 4. Controls and Procedures

The Company's management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Not applicable

Item 1A. Risk Factors

There have been no material changes in the risk factors affecting the Company that were identified in Item 1A of Part 1 of the Company's Form 10-K for the year ended December 31, 2010.

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

None

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Removed and Reserved

Item 5. Other Information

None

Item 6. Exhibits

No.	Description
3(i)	Articles of Incorporation of Norwood Financial Corp.(1)
3(ii)	Bylaws of Norwood Financial Corp. (2)
4.0	Specimen Stock Certificate of Norwood Financial Corp. (1)
10.1	Employment Agreement with Lewis J. Critelli (2)
10.2	Change in Control Severance Agreement with William S. Lance(2)
10.3	Norwood Financial Corp. Stock Option Plan (4)
10.4	Salary Continuation Agreement between the Bank and William W. Davis, Jr. (3)
10.5	Salary Continuation Agreement between the Bank and Lewis J. Critelli (3)
10.6	Salary Continuation Agreement between the Bank and Edward C. Kasper (3)
10.7	1999 Directors Stock Compensation Plan (3)
10.8	Salary Continuation Agreement between the Bank and Joseph A. Kneller (5)
10.9	Salary Continuation Agreement between the Bank and John H. Sanders (5)
10.10	2006 Stock Option Plan (6)
10.11	First and Second Amendments to Salary Continuation Agreement with William W. Davis, Jr. (7)
10.12	First and Second Amendments to Salary Continuation Agreement with Lewis J. Critelli (7)
10.13	First and Second Amendments to Salary Continuation Agreement with Edward C. Kasper (7)
10.14	First and Second Amendments to Salary Continuation Agreement with Joseph A. Kneller (7)
10.15	First and Second Amendments to Salary Continuation Agreement with John H. Sanders (7)
31.1	Rule 13a-14(a)/15d-14(a) Certification of CEO
31.2	Rule 13a-14(a)/15d-14(a) Certification of CFO

32 Certification pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of Sarbanes Oxley Act of 2002
101.INS XBRL Instance Document *

47

101.SCH XBRL Schema Document *
101.CAL XBRL Calculation Linkbase Document *
101.LAB XBRL Labels Linkbase Document *
101.PRE XBRL Presentation Linkbase Document *
101.DEF XBRL Definition Linkbase Document *

* Submitted as Exhibits 101 to this Form 10-Q are documents formatted in XBRL (Extensible Business Reporting Language). Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

- (1) Incorporated herein by reference into this document from the Exhibits to Form 10, Registration Statement initially filed with the Commission on April 29, 1996, Registration No. 0-28364
- (2) Incorporated by reference into this document from the identically numbered exhibits to the Registrant's Form 10-K filed with the Commission on March 15, 2010.
- (3) Incorporated herein by reference to the identically numbered exhibits of the Registrant's Form 10-K filed with the Commission on March 23, 2000.
- (4) Incorporated by reference into this document from the Exhibits to Form S-8 filed with the Commission on August 14, 1998, File No. 333-61487.
- (5) Incorporated herein by reference to the identically numbered exhibit to the Registrant's Form 10-K filed with the Commission on March 22, 2004.
- (6) Incorporated by reference to this document from Exhibit 4.1 to Registrant's Registration Statement on Form S-8 (File No. 333-134831) filed with the Commission on June 8, 2006.
- (7) Incorporated herein by reference from the Exhibits to the Registrant's Current Report on Form 8-K filed on April 4, 2006.

Signatures

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

NORWOOD FINANCIAL CORP.

Date: November 8, 2011

By: /s/ Lewis J. Critelli
Lewis J. Critelli
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 8, 2011

By: /s/ William S. Lance
William S. Lance
Senior Vice President, and Chief Financial
Officer
(Principal Financial Officer)