HUTTIG BUILDING PRODUCTS INC
Form 10-K
February 20, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2013

¨ **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 1-14982

HUTTIG BUILDING PRODUCTS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**43-0334550**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

555 Maryville University Drive

Suite 400

St. Louis, Missouri 63141

(Address of principal executive offices, including zip code)

(314) 216-2600

(Registrant s telephone number, including area code)

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

Title of Class	Name of Exchange on which Registered
Common, par value $0.01 per share	The NASDAQ Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a 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. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller Reporting Company	x

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of the last business day of the quarter ended **June 30, 2013** was approximately $50 **million**. For purposes of this calculation only, the registrant has excluded stock beneficially owned by the registrants directors and officers. By doing so, the registrant does not admit that such persons are affiliates within the meaning of Rule 405 under the Securities Act of 1933 or for any other purposes.

The number of shares of Common Stock outstanding on **February 10, 2014** was 24,656,211 shares.

DOCUMENTS INCORPORATED HEREIN BY REFERENCE.

Parts of the registrant s definitive proxy statement for the 2014 Annual Meeting of Shareholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

PART I

ITEM 1 BUSINESS

General

Huttig Building Products, Inc., a Delaware corporation incorporated in 1913, was founded in 1885 and is a leading domestic distributor of millwork, building materials and wood products used principally in new residential construction and in home improvement, remodeling and repair work. We purchase from leading manufacturers and distribute our products through 27 wholesale distribution centers serving 41 states. Our distribution centers sell principally to building materials dealers, national buying groups, home centers and industrial users, including makers of manufactured homes. For the year ended December 31, 2013, we generated net sales of $561.5 million.

We conduct our business through a two-step distribution model. This means we resell the products we purchase from manufacturers to our customers, who then sell the products to the final end users, who are typically professional builders and independent contractors engaged in residential construction and remodeling projects.

Our products fall into three categories: (i) millwork, which includes doors, windows, moulding, stair parts and columns, (ii) general building products, which include composite decking, connectors, fasteners, housewrap, roofing products and insulation, and (iii) wood products, which include engineered wood products, such as floor systems, as well as wood panels and lumber.

Doors and engineered wood products often require an intermediate value added service between the time the product leaves the manufacturer and before it is delivered to the final customer. We perform such services, on behalf of our customers, which include pre-hanging doors and cutting engineered wood products from standard lengths to job-specific requirements. In addition, with respect to the majority of our products, we have the capability to buy in bulk and disaggregate these large shipments to meet individual customer stocking requirements. For some products, we carry a depth and breadth of products that our customers cannot reasonably stock themselves. Our customers benefit from our business capabilities because they do not need to invest capital in door hanging facilities or cutting equipment, nor do they need to incur the costs associated with maintaining large inventories of products. Our size, broad geographic presence, extensive fleet and logistical capabilities enable us to purchase products in large volumes at favorable prices, stock a wide range of products for rapid delivery and manage inventory in a reliable, efficient manner.

We serve our customers, whether they are a local dealer or a national account, through our 27 wholesale distribution centers. Our broad geographic footprint enables us to work with our customers and suppliers to ensure that local inventory levels, merchandising, purchasing and pricing are tailored to the requirements of each market. Each distribution center also has access to our single-platform nationwide inventory management system. This provides the local manager with real-time inventory availability and pricing information. We support our distribution centers with credit and financial management, training and marketing programs and human resources expertise. We believe that these distribution capabilities and efficiencies offer us a competitive advantage as compared to those of many local and regional competitors.

In this Annual Report on Form 10-K, when we refer to Huttig, the Company , we or us, we mean Huttig Building Products, Inc. and its subsidiary and predecessors unless the context indicates otherwise.

Industry Characteristics and Trends

The residential building materials distribution industry is characterized by its substantial size, its highly fragmented ownership structure and an increasingly competitive environment. The industry can be broken into two categories: (i) new construction and (ii) home repair and remodeling.

Residential construction activity in both categories is closely linked to a variety of factors directly affected by general economic conditions, including employment levels, job and household formation, interest rates, housing prices, tax policy, availability of mortgage financing, prices of commodity wood and steel products, immigration patterns, regional demographics and consumer confidence. We monitor a broad set of macroeconomic and regional indicators, including new housing starts and permit issuances, as indicators of our potential future sales volume.

New housing activity in the United States has shown modest improvement each year since 2009, the trough period of the recent housing downturn. However, 2013 activity is still below the historical average of total housing starts from 1959 to 2013 of approximately 1.5 million starts based on statistics tracked by the US Census Bureau (Historical Average). Total new housing starts in the United States were approximately 0.9 million, 0.8 million and 0.6 million in 2013, 2012 and 2011, respectively. Single family starts were 0.6 million, 0.5 million and 0.4 million in 2013, 2012 and 2011, respectively, based on data from the U.S. Census Bureau. According to the U.S. Census Bureau, total spending on new single family residential construction was $169 billion, $132 billion and $108 billion in 2013, 2012 and 2011, respectively.

We service large local, regional and national independent building products dealers who in turn sell to contractors and professional builders. These large local, regional and national building products dealers, often referred to as pro dealers, continue to distribute a significant portion of the residential building materials sold in the United States. These pro dealers operate in an increasingly competitive environment. Consolidation among building products manufacturers favors distributors that can buy in bulk and break down large production runs to specific local requirements. In addition, increasing scale and sophistication among professional builders and contractors places a premium on pro dealers that can make a wide variety of building products readily available at competitive prices. In response to the increasingly competitive environment for building products, many pro dealers have either consolidated or formed buying groups in order to increase their purchasing power and/or service levels.

We generally do not compete with building products mass retailers such as The Home Depot and Lowe s. Their business model for building products is primarily suited to sell products that require little or no differentiation with very high turn volumes. Conversely, a substantial portion of our product offering consists of products that typically require intermediate value-added handling and/or a large breadth of SKUs.

We believe the evolving characteristics of the residential building materials distribution industry, particularly the consolidation trend, favor companies like us that operate nationally and have significant infrastructure in place to accommodate the needs of customers across geographic regions. We are the only national distributor of millwork products. Because of our wide geographic presence, size, purchasing power, material handling efficiencies and investment in millwork services, we believe we are well positioned to serve the needs of the consolidating pro dealer community.

Products

Our goal is to offer products that allow us to provide value to our customers, either by performing incremental services on the products before delivering them to customers, buying products in bulk and disaggregating them for individual customers or carrying a depth and breadth of products that customers cannot reasonably stock themselves at each location. Our products can be classified into three main categories:

Millwork, including exterior and interior doors, pre-hung door units, windows, patio doors, mouldings, frames, stair parts and columns. Key brands in this product category include Therma-Tru, Masonite, Woodgrain Doors HB&G, Simpson Door, Huttig Windows, Windsor Windows, and Rogue Valley Door;

General building products, such as roofing, siding, insulation, flashing, housewrap, connectors and fasteners, decking, drywall, kitchen cabinets and other miscellaneous building products. Key brands in this product category include Louisiana Pacific, Simpson Strong-Tie, Timbertech, AZEK, BP Roofing, Grace, Fiberon, Owens Corning, Typar, Atlas Roofing, Alpha Protech, and CertainTeed;

Wood products, which include engineered wood products, such as floor systems, and other wood products, such as lumber and wood panels. Within the wood products category, engineered wood continues to be a focus product for us. The engineered wood product line offers us the ability to provide our customers with value-added services, such as floor system take-offs, cut-to-length packages and just-in-time, cross-dock delivery capabilities.

The following table sets forth information regarding the percentage of our net sales represented by our principal product categories sold during each of the last three fiscal years. While the table below generally indicates the mix of our sales by product category, changes in the prices of commodity wood products and in unit volumes sold could affect our product mix on a year-to-year basis.

	2013	2012	2011
Millwork	50%	47%	45%
Building Products	38%	42%	44%
Wood Products	12%	11%	11%

Customers

During 2013, we served over 4,000 customers, with one customer Lumbermen s Merchandising Corporation (LMC) accounting for 12% of our sales in 2013 and 2012 and 11% of our sales in 2011. LMC is a buying group representing multiple building material dealers. Building materials pro dealers represent our single largest customer group. Our top 10 customers accounted for approximately 38% of our total sales in 2013.

Within the pro dealer category, a large percentage of our sales are to national accounts, including buying groups. These are large pro dealers, or groups of pro dealers, that generally operate in more than one state or region. To a lesser extent, we also sell to the retail home centers. We believe that our size, which lets us purchase in bulk, achieve operating efficiencies, operate on a national scale and offer competitive pricing, makes us well suited to service the consolidating pro dealer community. Our sales to national accounts, including buying groups, were 42% of our total sales in 2013 and 40% in each of 2012 and 2011.

Organization

Huttig operates on a nationwide basis. Customer sales are conducted through 27 distribution centers serving 41 states. Administrative and executive management functions are centralized at our headquarters office located in St. Louis, Missouri. We believe that this structure permits us to be closer to our customers and serve them better, while being able to take advantage of certain efficiencies of scale that come from our size.

Headquarter functions include those activities that can be shared across our full distribution platform. These include financial management, information technology, human resources, legal, internal audit and investor relations along with small corporate operations, marketing and product management groups.

Operating responsibility resides with each distribution center s general manager. The general manager assumes responsibility for daily operations, including sales, purchasing, personnel and logistics. Each distribution center generally maintains its own sales, warehouse and logistic personnel supported by a small administrative team.

Sales

Sales responsibility principally lies with general managers at our distribution centers. The sales function is generally divided into two channels: outside sales and inside sales. Our outside field representatives make on-site calls to local and regional customers. Our inside sales people generally receive telephone orders from customers and support our outside sales function. In addition, we maintain a national account sales team to serve national customers. Our outside sales force is generally compensated by a base salary or draw plus commissions determined primarily on profit margin.

Distribution Strategy and Operations

We conduct our business through a two-step distribution model. This means that we resell the products that we purchase from manufacturers to our customers, who then sell the products to the final end user. Our principal customer is the pro dealer. To lesser extent, we also sell to the retail home centers and certain industrial users, such as makers of manufactured housing.

Despite our nationwide reach, the local distribution center is still a principal focus of our operations, and we tailor our business to meet local demand and customer needs. We customize product selection, inventory levels, service offerings and prices to meet local market requirements. We support this strategy through our single platform information technology system. This system provides each distribution center s general manager real-time access to pricing, inventory availability and margin analysis. This system provides product information both for that location and across the entire Huttig network of distribution centers. More broadly, our sales force, in conjunction with our product management teams, works with our suppliers and customers to get the appropriate mix, quantity and pricing of products suited to each local market.

We purchased products from more than 800 different suppliers in 2013. We generally negotiate with our major suppliers on a national basis to leverage our total volume purchasing power, which we believe provides us with an advantage over our locally based competitors. The majority of our purchases are made from suppliers that offer payment discounts and volume related incentive programs. Although we generally do not have exclusive distribution rights for our key products and we do not have long-term contracts with many of our suppliers, we believe our national footprint, buying power and distribution network make us an attractive distributor for many manufacturers. Moreover, we have long-standing relationships with many of our key suppliers.

We regularly evaluate opportunities to introduce new products. This is primarily driven by customer demand or market requirements. We have found that customers generally welcome a greater breadth of product offering as it can improve their purchasing and operating efficiencies by providing for one stop shopping. Similarly, selectively broadening our product offering enables us to drive additional products through our distribution system, thereby increasing the efficiency of our operations by better utilizing our existing infrastructure.

We focus on selling respected, brand name products. We believe that brand awareness is an increasingly important factor in building products purchasing decisions. We generally benefit from the quality levels, marketing initiatives and product support provided by manufacturers of branded products. We also benefit by being associated with the positive attributes that customers typically equate with branded products.

Competition

We compete with many local and regional building product distributors and, in certain markets and product categories, with national building product distributors. In certain markets, we also compete with national building materials suppliers with national distribution capabilities. We distribute products for some manufacturers that also engage in direct sales.

The principal factors on which we compete are pricing and availability of product, service and delivery capabilities, ability to assist with problem solving, customer relationships, geographic coverage and breadth of product offerings.

Our size and geographic coverage are advantageous in obtaining and retaining distribution rights for brand name products. Our size also permits us to attract experienced sales and service personnel and gives us the resources to provide company-wide sales, product and service training programs. By working closely with our customers and suppliers and utilizing our single information technology platform, we believe our branches are well positioned to maintain appropriate inventory levels and to deliver completed orders on time.

Seasonality, Market Conditions and Working Capital

Various cyclical and seasonal factors, such as general economic conditions and weather, historically have caused our results of operations to fluctuate from period to period. Our size, extensive nationwide operating model, and the geographic diversity of our distribution centers to some extent mitigate our exposure to these cyclical and seasonal factors. These factors include levels of new construction, home improvement and remodeling activity, weather, interest rates and other local, regional and national economic conditions.

Our results of operations are affected by new housing activity in the United States. In 2013, total housing starts increased 18%, to 0.9 million, but were still below the Historical Average of approximately 1.5 million. Based on the current level of housing activity and industry forecasts, we expect new housing activity could continue to increase into 2014, though still remain below the Historical Average.

We anticipate that fluctuations from period to period will continue in the future. Our first and fourth quarters are generally adversely affected by winter weather patterns in the Northeast, Midwest and Northwest, which typically result from seasonal decreases in levels of construction activity in these areas. Because much of our overhead and expenses remain relatively fixed throughout the year, our operating profits also tend to be lower during the first and fourth quarters. In addition, other weather patterns, such as hurricane season in the Southeast region of the United States during the third and fourth quarters, can have an adverse impact on our results in a particular period.

We depend on cash flow from operating activities and funds available under our secured credit facility to finance seasonal working capital needs, capital expenditures and any acquisitions that we may undertake. We typically generate cash from working capital reductions in the fourth quarter of the year and build working capital during the first quarter in preparation for our second and third quarters. Our working capital requirements are generally greatest in the second and third quarters, reflecting the seasonal nature of our business. The second and third quarters are also typically our strongest operating quarters, largely due to more favorable weather throughout many of our markets compared to the first and fourth quarters. We maintain significant inventories to meet the rapid delivery requirements of our customers and to enable us to obtain favorable pricing, delivery and service terms with our suppliers. At December 31, 2013 and 2012, inventories and accounts receivable in the aggregate constituted approximately 73% and 70% of our total assets, respectively. We closely monitor operating expenses and inventory levels during seasonally affected periods and, to the extent possible, manage variable operating costs to minimize the seasonal effects on our profitability.

Credit

Huttig s corporate management establishes an overall credit policy for sales to customers and then delegates responsibility for most credit decisions to regional credit personnel. Our credit policies, together with careful monitoring of customer balances, have resulted in bad debt expense of less than 0.1% of net sales in 2013 and approximately 0.1% in 2012 and 2011. Approximately 98% of our sales in 2013 were to customers to whom we had provided credit for those sales.

Backlog

Our customers generally order products on an as-needed basis. As a result, a substantial portion of product shipments in a given fiscal quarter result from orders received in that quarter. Consequently, order backlog represents only a very small percentage of the product sales that we anticipate in a given quarter and is not necessarily indicative of actual sales for any future period.

Trade Names

Historically, Huttig has operated under various trade names in the markets we serve, retaining the names of acquired businesses for a period of time to preserve local identification. To capitalize on our national presence,

all of our distribution centers operate under the primary trade name Huttig Building Products. Huttig has no material patents, trademarks, licenses, franchises or concessions other than the Huttig Building Products® name and logo, which are registered trademarks.

Environmental Matters

We are subject to federal, state and local environmental protection laws and regulations. We believe that we are in material compliance, or are taking action aimed at assuring material compliance, with applicable environmental protection laws and regulations. However, there can be no assurance that future environmental liabilities will not have a material adverse effect on our financial condition or results of operations.

We have been identified as a potentially responsible party in connection with the cleanup of contamination at our formerly owned property in Montana. See Part I, Item 3 Legal Proceedings.

In addition, some of our current and former distribution centers are located in areas of current or former industrial activity where environmental contamination may have occurred, and for which we, among others, could be held responsible. We currently believe that there are no material environmental liabilities at any of our distribution center locations.

Employees

As of December 31, 2013, we employed approximately 1,000 persons, of which approximately 14% were represented by eight unions. We have not experienced any significant strikes or other work interruptions in recent years and have maintained generally favorable relations with our employees. The Company has three union contracts which will require negotiations in 2014. See Item 1A- Risk Factors.

Available Information

Huttig files with the U.S. Securities and Exchange Commission quarterly and annual reports on Forms 10-Q and 10-K, respectively, current reports on Form 8-K and proxy statements pursuant to the Securities Exchange Act of 1934, in addition to other information as required. The public may read and copy our SEC filings at the SEC s Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549 and may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We file this information with the SEC electronically, and the SEC maintains a website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov.

Our website address is http://www.huttig.com. The contents of our website are not part of this Annual Report. We make available, free of charge at the Investors section of our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the 1934 Act. This information is available on our website as soon as reasonably practicable after we electronically file it with, or furnish it to, the SEC. Reports of beneficial ownership filed pursuant to Section 16(a) of the 1934 Act are also available on our website.

ITEM 1A RISK FACTORS

In addition to the other information contained in this Form 10-K, the following risk factors should be considered carefully in evaluating the Company s business. The Company s business, financial condition or results of operations could be materially adversely affected by any of these risks. Please note that additional risks not presently known to the Company or that the Company currently deems immaterial may also impair its business and operations.

Although the homebuilding industry is recovering from a prolonged significant downturn, any further downturn or a sustained continuation of current construction levels could continue to materially affect our business, liquidity and operating results.

Our sales and results of operations depend heavily on the strength of national and local new residential construction and home improvement and remodeling markets. The strength of these markets depends on new housing starts and residential renovation projects, which are a function of many factors beyond our control. Some of these factors include general economic conditions, employment levels, job and household formation, interest rates, housing prices, tax policy, availability of mortgage financing, prices of commodity wood and steel products, immigration patterns, regional demographics and consumer confidence.

The recent downturn in the residential construction market has been one of the most severe housing downturns in U.S. history. High unemployment, tighter lending standards and general economic uncertainty have contributed to a level of housing starts below historical levels over the past several years. New housing activity in the United States has shown modest improvement each year since 2009, the trough period of the recent housing downturn. However, 2013 activity is still well below the Historical Average of approximately 1.5 million starts.

We expect the level of new housing activity in 2014 to continue to be below the Historical Average, which could adversely affect our operating results. A prolonged continuation of current construction levels or any significant downturn in the major markets we serve or in the economy in general could have a material adverse effect on our operating results, liquidity and financial condition, including but not limited to our ability to comply with the financial covenant under the credit facility and the valuation of our goodwill. Reduced levels of construction activity may result in continued intense price competition among building materials suppliers, which may adversely affect our gross margins. We cannot provide assurance that our responses to the downturn or the government s attempts to address the troubles in the economy will be successful.

The industry in which we compete is highly cyclical, and any cyclical market factors resulting in lower demand or increased supply could have a materially adverse impact on our financial results.

The building products distribution industry is subject to cyclical market pressures caused by a number of factors that are out of our control, such as general economic and political conditions, inventory levels of new and existing homes for sale, levels of new construction, home improvement and remodeling activity, interest rates and population growth. To the extent that cyclical market factors adversely impact overall demand for building products or the prices that we can charge for our products, our net sales and margins would likely decline in the same time frame as the cyclical downturn occurs. Because much of our overhead and expense is relatively fixed in nature, a decrease in sales and margin generally has a significant adverse impact on our results of operations. For example, during the past several years, our results of operations have been adversely affected by the severe downturn in new housing activity in the United States. Also, to the extent our customers experience a downturns in their business, our ability to collect our receivables could be adversely affected. Finally, the unpredictable nature of the cyclical market factors that impact our industry make it difficult to forecast our operating results.

If we are unable to meet the financial covenant under our credit facility, the lenders could elect to accelerate the repayment of the outstanding balance and, in that event, we would be forced to seek alternative sources of financing.

We are party to a $120.0 million asset based senior secured revolving credit facility which contains a minimum fixed charge coverage ratio (FCCR) that is tested if our excess borrowing availability, as defined in the facility, reaches an amount in the range of $10.0 million to $15.0 million depending on our borrowing base at the time of testing. At the time of testing, our fixed charge coverage ratio would need to exceed 1.25:1.00. As of December 31, 2013, our FCCR was in excess of 1:25:1.00. However, if in the future we failed to meet the FCCR and we were unable to maintain excess borrowing availability of more than the applicable amount in the range of $10.0 million to $15.0 million, our lenders would have the right, but not the obligation, to terminate the loan

commitments and accelerate the repayment of the entire amount outstanding under the credit facility. The lenders also could foreclose on our assets that secure our credit facility. In that event, we would be forced to seek alternative sources of financing, which may not be available on terms acceptable to us, or at all.

Our excess borrowing availability at December 31, 2013 was $41.2 million. Our credit facility matures in December 2017.

Compliance with the restrictions and the financial covenant under our credit agreement will likely limit, at least in the near term, the amount available to us for borrowing under that facility and may limit management s discretion with respect to certain business matters.

The borrowings under our credit agreement are collateralized by substantially all of the Company s assets, including accounts receivable, inventory and property and equipment, and we are subject to certain operating limitations commonly applicable to a loan of this type, which, among other things, place limitations on indebtedness, liens, investments, mergers and acquisitions, dispositions of assets, cash dividends, stock repurchases and transactions with affiliates. A minimum fixed charge coverage ratio must be tested on a pro forma basis prior to consummation of certain significant business transactions outside the Company s ordinary course of business. These restrictions may limit management s ability to operate our business in accordance with management s discretion, which could limit our ability to pursue certain strategic objectives.

A significant portion of our sales are concentrated with a relatively small number of customers. A loss of one or more of these customers would have material adverse effect on our operating results, cash flow and liquidity.

In 2013, our top ten customers represented 38% of our sales, with one customer accounting for 12% of our sales. This customer is a buying group for multiple building material dealers. Although we believe that our relationships with our customers are strong, the loss of one or more of these customers could have a material adverse effect on our operating results, cash flow and liquidity.

A significant portion of our sales are on credit to our customers. Material changes in their creditworthiness or our inability to forecast deterioration in their credit position could have a material adverse effect on our operating results, cash flow and liquidity.

The majority of our sales are on account where we provide credit to our customers. In 2013, bad debt expense to total net sales was less than 0.1%. Our customers are generally susceptible to the same economic business risks as we are. Furthermore, we may not necessarily be aware of any deterioration in their financial position. If our customers financial position becomes impaired, it could have a significant adverse impact on our bad debt exposure and could have a material adverse effect on our operating results, cash flow and liquidity.

Fluctuation in prices of commodity wood and steel products that we buy and then resell may have a significant impact on our results of operations.

Changes in wood and steel commodity prices between the time we buy these products and the time we resell them have occurred in the past, and we expect fluctuations to occur again in the future. Such changes can adversely affect the gross margins that we realize on the resale of the products. We may be unable to manage these fluctuations effectively or minimize any negative impact of these changes on our financial condition and results of operations.

The termination of key supplier relationships may have an immediate material adverse effect on our financial condition and results of operations.

We distribute building materials that we purchase from a number of major suppliers. As is customary in our industry, most of our relationships with these suppliers are terminable without cause on short notice. Slightly

more than half of our purchases are concentrated with ten suppliers. Although we believe that relationships with our existing suppliers are strong and that in most cases we would have access to similar products from competing suppliers, the termination of key supplier relationships or any other disruption in our sources of supply, particularly of our most commonly sold items, could have a material adverse effect on our financial condition and results of operations. Supply shortages resulting from unanticipated demand or production difficulties could occur from time to time and could have a material adverse effect on our financial condition and results of operations.

The building materials distribution industry is fragmented and competitive, and we may not be able to compete successfully with some of our existing competitors or new entrants in the markets we serve.

The building materials distribution industry is fragmented and competitive. Our competition varies by product line, customer classification and geographic market. The principal competitive factors in our industry are:

- pricing and availability of product;
- service and delivery capabilities;
- ability to assist with problem-solving;
- customer relationships;
- geographic coverage; and
- breadth of product offerings.

Also, financial stability is important to manufacturers and customers in choosing distributors for their products.

We compete with many local, regional and, in some markets and product categories, national building materials distributors and dealers. In addition, some product manufacturers sell and distribute their products directly to our customers, and the volume of such direct sales could increase in the future. Manufacturers of products distributed by us may also enter into exclusive supplier arrangements with our competition. Further, home center retailers, which have historically concentrated their sales efforts on retail consumers and small contractors, may intensify their marketing efforts to larger contractors and homebuilders. Some of our competitors have greater financial and other resources and may be able to withstand sales or price decreases better than we can. We also expect to continue to face competition from new market entrants. We may be unable to continue to compete effectively with these existing or new competitors, which could have a material adverse effect on our financial condition and results of operations.

We have retained accident and claims risk under our insurance programs. Significant claims, and/or our ability to accurately estimate the liability for these claims could have a material adverse effect on our operating results.

We retain a portion of the accident and claims risk under vehicle liability, workers compensation, medical and other insurance programs. We have multiple claims of various sizes and forecast the number of claims in determining the portion of accident risk we are willing to self insure. We base loss accruals on our best estimate of the cost of resolution of these matters and adjust them periodically as circumstances change. Due to limitations inherent in the estimation process, our estimates may change. Changes in the actual number of large claims or changes in the estimates of these accruals may have a material adverse affect on our results of operations in any such period.

In addition, our insurance underwriters require collateral, generally in the form of letters of credit, which reduce our borrowing availability under our senior secured credit facility. Changes in the actual number of large claims could increase our collateral requirements and reduce our borrowing availability under our credit facility.

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Federal and state transportation regulations, as well as increases in the cost of fuel, could impose substantial costs on us, which could adversely affect our results of operations.

We use our own fleet of approximately 150 tractors, 20 trucks and 320 trailers to service customers throughout the United States. The U.S. Department of Transportation, or DOT, regulates our operations, and we are subject to safety requirements prescribed by the DOT. Vehicle dimensions and driver hours of service also are subject to both federal and state regulation. More restrictive limitations on vehicle weight and size, trailer length and configuration, or driver hours of service could increase our costs.

In addition, distributors are inherently dependent upon energy to operate and, therefore, are impacted by changes in diesel fuel prices. The cost of fuel has reached historically high levels during portions of the last three years, is largely unpredictable and has a significant impact on the Company s results of operations. Fuel availability, as well as pricing, is also impacted by political and economic factors. It is difficult to predict the future availability of fuel due to the following factors, among others: dependency on foreign imports of crude oil and the potential for hostilities or other conflicts in oil producing areas; limited refining capacity; and the possibility of changes in governmental policies on fuel production, transportation and marketing. Significant disruptions in the supply of fuel could have a negative impact on fuel prices and thus the Company s operations and results of operations.

Our failure to attract and retain key personnel could have a material adverse effect on our future success.

Our future success depends, to a significant extent, upon the continued service of our executive officers and other key management and sales personnel and on our ability to continue to attract, retain and motivate qualified personnel. The loss of the services of one or more key employees or our failure to attract, retain and motivate qualified personnel could have a material adverse effect on our business.

A number of our employees are unionized, and any work stoppages by our unionized employees may have a material adverse effect on our results of operations.

Approximately 14% of our employees are represented by labor unions as of December 31, 2013. As of December 31, 2013, we had eight collective bargaining agreements. The Company has three union contracts which will require negotiations in 2014. We may become subject to significant wage increases or additional work rules imposed by future agreements with labor unions representing our employees. Any such cost increases or new work rule implementation could increase our operating expenses to a material extent. In addition, although we have not experienced any strikes or other significant work interruptions in recent years and have maintained generally favorable relations with our employees, no assurance can be given that there will not be any work stoppages or other labor disturbances in the future, which could adversely impact our financial results.

Our unionized employees generally participate in certain multi-employer pension plans and funding requirements for these plans, particularly underfunded plans, may have a material adverse effect on our results of operations.

We participate in various multi-employer pension plans. Some of these multi-employer plans may be underfunded at any point in time. While the underfunded status may be cured in the normal course of plan management, a significant obligation may be created which could have a material adverse effect on our operations or could impact our decision to close or consolidate certain operating locations.

We face the risks that product liability claims and other legal proceedings relating to the products we distribute may adversely affect our business and results of operations.

As is the case with other companies in our industry, even though our suppliers generally warrant the products we sell, we face the risk of product liability and other claims of the type that are typical to our industry in the event that the use of products that we have distributed causes other damages. Product liability claims in the

future, regardless of their ultimate outcome and whether or not covered under our insurance policies or indemnified by our suppliers, could result in costly litigation and have a material adverse effect on our business and results of operations.

We may acquire other businesses, and, if we do, we may be unable to integrate them with our business, which may impair our financial performance.

If we find appropriate opportunities, we may acquire businesses that we believe provide strategic opportunities. If we acquire a business, the process of integration may produce unforeseen operating difficulties and expenditures and may absorb significant attention of our management that would otherwise be available for the ongoing development of our business. If we make future acquisitions, we may issue shares of stock that dilute other stockholders, expend cash, incur debt, assume contingent liabilities or create additional expenses relating to amortizing intangible assets with estimated useful lives, any of which might harm our business, financial condition or results of operations.

We face risks of incurring significant costs to comply with environmental regulations.

We are subject to federal, state and local environmental protection laws and regulations and may have to incur significant costs to comply with these laws and regulations in the future. We have been identified as a potentially responsible party in connection with the cleanup of contamination at a formerly owned property in Montana, where we are voluntarily remediating the property under the oversight of the Montana Department of Environmental Quality (Montana DEQ). Until the Montana DEQ selects and orders us to implement a final remedy, we can give no assurance as to the scope or cost to us of any final remediation order. In addition, some of our current and former distribution centers are located in areas of current or former industrial activity where environmental contamination may have occurred, and for which we, among others, could be held responsible. As a result, we may incur material environmental liabilities in the future with respect to our current or former distribution center locations.

Goodwill is a significant portion of our total assets and is tested for impairment at least annually, which could result in a material non-cash write-down of goodwill.

Goodwill is subject to impairment tests at least annually and between annual tests in certain circumstances. We have incurred non-cash impairment charges in certain prior years, for example, during 2012 we recorded non-cash impairment charges of goodwill of $1.9 million primarily related to a reduction in fair value of one reporting unit as a result of the continuing downturn in the residential construction and real estate markets. At December 31, 2013, we had goodwill assets of $6.3 million. We may be required to incur additional non-cash impairment charges in the future that could have a material adverse effect on our operating results.

Our financial results reflect the seasonal nature of our operations.

Our first quarter and our fourth quarter revenues are typically adversely affected by winter construction cycles and weather patterns in colder climates as the level of activity in the new construction and home improvement markets decreases. Because much of our overhead and expense remains relatively fixed throughout the year, our operating profits also tend to be lower during the first and fourth quarters. In addition, other weather patterns, such as hurricane season in the Southeast region of the United States during the third and fourth quarters, can have an adverse impact on our profits in a particular period.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

Our corporate headquarters is located at 555 Maryville University Drive, Suite 400, St. Louis, Missouri 63141, in a leased facility. We own 13 of our distribution centers and lease the balance. Warehouse space at

distribution centers aggregated to approximately 3.2 million square feet as of December 31, 2013. Distribution centers range in size from 21,100 square feet to 260,000 square feet. The types of facilities at these centers vary by location, from traditional wholesale distribution warehouses to facilities with broad product offerings and capabilities for a wide range of value added services such as pre-hung door operations. We believe that our locations are well maintained and adequate for their purposes.

ITEM 3 LEGAL PROCEEDINGS

We are involved in various claims and litigation arising principally in the ordinary course of business. We believe that the disposition of these matters will not have a material adverse effect on our business or our financial condition.

We are subject to federal, state and local environmental protection laws and regulations. We believe that we are in compliance, or are taking action aimed at assuring compliance, with applicable environmental protection laws and regulations. However, there can be no assurance that future environmental liabilities will not have a material adverse effect on our financial condition or results or operations.

Environmental Matters

In 1995, Huttig was identified as a potentially responsible party in connection with the cleanup of contamination at a formerly owned property in Montana that was used for the manufacture of wood windows. We are voluntarily remediating this property under the oversight of and in cooperation with the Montana Department of Environmental Quality (Montana DEQ) and are complying with a 1995 unilateral administrative order of the Montana DEQ to complete a remedial investigation and feasibility study. The remedial investigation was completed by Huttig and approved in 1998 by the Montana DEQ, which has also issued its final risk assessment of this property. Since 1998 we have remained in active discussions with the Montana DEQ, expanded the remedial investigation where warranted, implemented voluntary interim cleanup actions, conducted pilot tests, and tested remedial technologies in the field. We are currently working with the Montana DEQ to develop a final feasibility study which will present and evaluate several potential remedies. The Montana DEQ is ultimately expected to publicize a final remedy for public comment. After consideration of public comments, the Montana DEQ will then publish a record of decision and negotiate with Huttig for an administrative order of consent on the implementation of the final remedy. We spent less than $0.5 million on costs related to this site in each of the years ended December 31, 2013, 2012 and 2011. The annual level of future remediation expenditures is difficult to estimate because of the uncertainty relating to the final remedy to be selected by the Montana DEQ. As of December 31, 2013, we have accrued $0.6 million for future costs of remediating this site, which management believes represents a reasonable estimate based on current facts and circumstances and the currently expected costs of remediation. Until the Montana DEQ selects a final remedy, however, management cannot estimate the top of the range of loss or cost to Huttig of the final remediation order. As a result, we may incur material adverse effect on the consolidated financial statements in the future with respect to this property.

In addition, some of our current and former distribution centers are located in areas of current or former industrial activity where environmental contamination may have occurred, and for which we, among others, could be held responsible. We currently believe that there are no material environmental liabilities at any of our distribution center locations.

ITEM 4 MINE SAFETY DISCLOSURES

Not Applicable.

PART II

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

Through December 6, 2013, our common stock traded over the counter under the symbol HBPI.PK . Effective December 9, 2013, our common stock began trading on the NASDAQ Capital Market exchange under the symbol HBP .

At February 10, 2014, there were approximately 1,800 holders of record of our common stock. The following table sets forth the range of high and low sale prices of our common stock:

	2013		2012	
	High	**Low**	**High**	**Low**
First Quarter	$ 3.00	$ 1.30	$ 1.55	$ 0.52
Second Quarter	3.00	2.00	1.50	0.63
Third Quarter	2.89	2.11	1.60	1.05
Fourth Quarter	3.96	2.40	1.67	1.10

In order to make cash generated available for use in operations, debt reduction, stock repurchases and potential acquisitions, we have never declared, nor do we anticipate at this time declaring or paying, any cash dividends on our common stock. Provisions of our credit facility contain various covenants, which, among other things, limit our ability to incur indebtedness, incur liens, make certain types of acquisitions, declare or pay dividends or sell assets. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

See Part III, Item 12, for information on securities authorized for issuance under equity compensation plans.

Performance Graph

The following Performance Graph and related information shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that the Company specifically incorporates it by reference into such filing.

The following table compares total shareholder returns for the Company over the last five years to the Standard and Poor s 500 Stock Index and that of a peer group made up of other building material and industrial products distributors assuming a $100 investment made on December 31, 2008. Each of the three measures of cumulative total return assumes reinvestment of dividends. The stock performance shown on the graph below is not necessarily indicative of future price performance.

	Huttig Building Products	S&P 500	Peer Group Index
12/08	$ 100.00	$ 100.00	$ 100.00
12/09	$ 163.04	$ 126.46	$ 141.41
12/10	$ 206.52	$ 145.51	$ 180.27
12/11	$ 113.04	$ 148.58	$ 179.83
12/12	$ 347.83	$ 172.35	$ 242.86
12/13	$ 839.13	$ 228.18	$ 319.06

(1) The peer group includes the following companies: QEP Co., Watsco Inc., Bluelinx Holdings, Inc. and Universal Forest Products, Inc.

ITEM 6 SELECTED CONSOLIDATED FINANCIAL DATA

The following table summarizes certain selected financial data of continuing operations of Huttig for each of the five years in the period ended December 31, 2013. The information contained in the following table may not necessarily be indicative of our future performance. Such historical data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and notes thereto included elsewhere in this report.

	Year Ended December 31,				
	2013	**2012**	**2011**	**2010**	**2009**
	(In Millions, Except Per Share Data)				
Income Statement Data:(1)					
Net sales	$ 561.5	$ 521.1	$ 479.3	$ 467.7	$ 455.2
Cost of sales	450.4	420.4	390.1	382.5	371.1
Gross margin	111.1	100.7	89.2	85.2	84.1
Operating expenses	104.8	98.4	99.0	103.3	105.7
Goodwill impairment		1.9	0.4		1.0
Gain on disposal of capital assets		(2.4)		(0.4)	(1.5)
Operating income (loss)	6.3				

Balance, June 30, 2014 $ 15,097 $ 140,150 $ 87,356 $ 1,562 $ $ 244,165

See notes to consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

For the Six Months Ended June 30	**2015**	**2014**
Cash flows from operating activities:		
Net income	$ 9,475	$ 8,029
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	784	947
Amortization of deferred loan costs	284	78
Amortization of intangibles	600	676
Net accretion of purchase accounting adjustments on tangible assets	(501)	(1,965)
Provision for loan losses	1,500	2,058
Net gain on sale of other real estate owned	(110)	(41)
Net loss on disposal of equipment		63
Net amortization of investment securities	2,054	2,116
Loans originated for sale	(14,079)	(4,866)
Proceeds from sale of loans originated for sale	15,155	3,527
Net (gain) loss on sale of loans originated for sale	(469)	339
Net gain on sale of investment securities	(832)	(160)
Life insurance investment income	(377)	(395)
Deferred income tax expense (benefit)	119	
Stock based compensation	35	11
Net change in:		
Accrued interest receivable	73	290
Other assets	(3,235)	(4,764)
Accrued interest payable	(131)	(143)
Stock appreciation rights		301
Other liabilities	(1,478)	3,841
Net cash provided by operating activities	8,867	9,942
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale	50,981	4,984
Proceeds from repayments of investment securities:		
Available-for-sale	28,253	18,245
Held-to-maturity	1,016	1,352
Purchases of investment securities:		
Available-for-sale	(61,162)	(34,289)
Held-to-maturity		
Net redemption of restricted equity securities	330	182
Net increase in lending activities	(22,414)	(3,223)
Purchases of premises and equipment	(1,953)	(636)
Proceeds from the sale of premises and equipment		25

Proceeds from sale of other real estate owned	463	321
Net cash used in investing activities	(4,486)	(13,039)
Cash flows from financing activities:		
Net increase (decrease) in deposits	(424)	43,866
Repayment of long-term debt	(1,450)	(1,791)
Net increase (decrease) in short-term borrowings	6,303	(7,964)
Redemption of common stock		(70)
Retirement of stock options		(95)
Purchase of treasury stock		(70)
Cash dividends paid	(4,679)	(4,681)
Net cash provided by (used in) financing activities	(250)	29,195
Net increase (decrease) in cash and cash equivalents	4,131	26,098
Cash and cash equivalents at beginning of year	31,426	51,310
Cash and cash equivalents at end of year	$ 35,557	$ 77,408

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

For the Six Months Ended June 30	**2015**	**2014**
Supplemental disclosures:		
Cash paid during the period for:		
Interest	$ 3,114	$ 3,557
Income taxes	1,800	1,300
Noncash items:		
Transfers of loans to other real estate	$ 247	$ 258
Retirement of treasury shares		6,300
Acquisition:		
Fair value of assets acquired:		
Loans, net	$ 157	$ 1,417
Premises and equipment	(50)	(50)
Core deposit and other intangible assets	(600)	(676)
	$ (493)	$ 691
Fair value of liabilities assumed:		
Deposits	$ 367	$ 571
Long-term debt	27	27
	$ 394	$ 598

See notes to consolidated financial statements

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

1. Summary of significant accounting policies:

Nature of operations:

Peoples Financial Services Corp., a bank holding company incorporated under the laws of Pennsylvania, provides a full range of financial services through its wholly-owned subsidiary, Peoples Security Bank and Trust Company (Peoples Bank), including its subsidiaries, Peoples Advisors, LLC and Penseco Realty, Inc. (collectively, the Company or Peoples). The Company services its retail and commercial customers through twenty-six full-service community banking offices located within the Lackawanna, Lehigh, Luzerne, Monroe, Susquehanna, Wayne and Wyoming Counties of Pennsylvania and Broome County of New York.

Basis of presentation:

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. All significant intercompany balances and transactions have been eliminated in consolidation. Prior-period amounts are reclassified when necessary to conform to the current year s presentation. These reclassifications did not have any effect on the operating results or financial position of the Company. The operating results and financial position of the Company for the three and six months ended and as of June 30, 2015, are not necessarily indicative of the results of operations and financial position that may be expected in the future.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly susceptible to material change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, the valuation of deferred tax assets, determination of other-than-temporary impairment losses on securities, impairment of goodwill and fair value of assets acquired and liabilities assumed in business combinations. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, reference is made to the Company s Annual Report on Form 10-K for the period ended December 31, 2014.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2015, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

Recent accounting standards:

In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-08, Business Combinations (Topic 805): Pushdown Accounting Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin (SAB) 115. This ASU rescinds certain SEC guidance in order to conform with ASU 2014-17, Pushdown Accounting. ASU 2014-17 was issued in November 2014 and provides a reporting entity that is a business or nonprofit activity (an acquiree) the option to apply pushdown accounting to its separate financial statements when an acquirer obtains control of the acquiree. SAB 115 became effective November 21, 2014. The adoption of ASU 2015-18 did not have a material effect on the operating results or financial position of the Company.

2. Other comprehensive income (loss):

The components of other comprehensive loss and their related tax effects are reported in the Consolidated Statements of Income and Comprehensive Income. The accumulated other comprehensive income (loss) included in the Consolidated Balance Sheets relates to net unrealized gains and losses on investment securities available-for-sale and benefit plan adjustments.

The components of accumulated other comprehensive loss included in stockholders equity at June 30, 2015 and December 31, 2014 is as follows:

	June 30, 2015	December 31, 2014
Net unrealized gain on investment securities available-for-sale	$ 4,768	$ 6,292
Related income taxes	1,669	2,202
Net of income taxes	3,099	4,090
Benefit plan adjustments	(7,567)	(7,567)
Related income taxes	(2,648)	(2,648)
Net of income taxes	(4,919)	(4,919)
Accumulated other comprehensive loss	$ (1,820)	$ (829)

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

2. Other comprehensive income (loss) continued:

Other comprehensive income (loss) and related tax effects for the three and six months ended June 30, 2015 and 2014 is as follows:

Three months ended June 30	2015	2014
Unrealized gain (loss) on investment securities available-for-sale	$ (1,459)	$ 1,242
Net gain on the sale of investment securities available-for-sale (1)		(160)
Other comprehensive income (loss) gain before taxes	(1,459)	1,082
Income tax expense (benefit)	(510)	378
Other comprehensive income (loss)	$ (949)	$ 704

Six months ended June 30	2015	2014
Unrealized gain (loss) on investment securities available-for-sale	$ (692)	$ 3,636
Net gain on the sale of investment securities available-for-sale (1)	(832)	(160)
Other comprehensive income (loss) gain before taxes	(1,524)	3,476
Income tax expense (benefit)	(533)	1,216
Other comprehensive income (loss)	$ (991)	$ 2,260

(1) Represents amounts reclassified out of accumulated comprehensive income and included in gains on sale of investment securities on the consolidated statements of income and comprehensive income.

3. Earnings per share:

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company

relate solely to outstanding stock options, and are determined using the treasury stock method.

There were no shares considered anti-dilutive for the three and six month periods ended June 30, 2015 and 2014.

	2015		2014	
For the three months ended June 30	**Basic**	**Diluted**	**Basic**	**Diluted**
Net Income (Numerator)	$ 4,431	$ 4,431	$ 3,331	$ 3,331
Average common shares outstanding (Denominator)	7,546,198	7,546,198	7,548,358	7,570,883
Earnings per share	$ 0.59	$ 0.59	$ 0.44	$ 0.44

	2015		2014	
For the six months ended June 30	**Basic**	**Diluted**	**Basic**	**Diluted**
Net Income (Numerator)	$ 9,475	$ 9,475	$ 8,029	$ 8,029
Average common shares outstanding (Denominator)	7,547,272	7,547,272	7,549,300	7,575,655
Earnings per share	$ 1.26	$ 1.26	$ 1.06	$ 1.06

Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

4. Investment securities:

The amortized cost and fair value of investment securities aggregated by investment category at June 30, 2015 and December 31, 2014 are summarized as follows:

June 30 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury securities	$ 30,631	$ 84	$ 30	$ 30,685
U.S. Government-sponsored enterprises	85,377	490	5	85,862
State and municipals:				
Taxable	15,930	804	22	16,712
Tax-exempt	109,241	3,886	613	112,514
Mortgage-backed securities:				
U.S. Government agencies	32,995	156	62	33,089
U.S. Government-sponsored enterprises	39,848	250	170	39,928
Total	$ 314,022	$ 5,670	$ 902	$ 318,790
Held-to-maturity:				
State and municipals Tax-exempt	$ 7,369	$ 103	$ 53	$ 7,419
Mortgage-backed securities:				
U.S. Government agencies	93	1		94
U.S. Government-sponsored enterprises	6,164	427		6,591
Total	$ 13,626	$ 531	$ 53	$ 14,104

Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

4. Investment securities (continued):

December 31, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury securities	$ 48,393	$ 157		$ 48,550
U.S. Government-sponsored enterprises	95,990	337	$ 82	96,245
State and municipals:				
Taxable	16,490	943	26	17,407
Tax-exempt	87,954	4,971	24	92,901
Mortgage-backed securities:				
U.S. Government agencies	37,511	132	167	37,476
U.S. Government-sponsored enterprises	46,956	277	226	47,007
Total	$ 333,294	$ 6,817	$ 525	$ 339,586
Held-to-maturity:				
Tax-exempt state and municipals	$ 7,370	$ 105	$ 38	$ 7,437
Mortgage-backed securities:				
U.S. Government agencies	100	2		102
U.S. Government-sponsored enterprises	7,195	481		7,676
Total	$ 14,665	$ 588	$ 38	$ 15,215

The maturity distribution of the fair value, which is the net carrying amount, of the debt securities classified as available-for-sale at June 30, 2015, is summarized as follows:

June 30, 2015	Fair Value
Within one year	$ 28,289
After one but within five years	108,675
After five but within ten years	54,059
After ten years	54,750
	245,773

Mortgage-backed securities	73,017
Total	$ 318,790

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

4. Investment securities (continued):

The maturity distribution of the amortized cost and fair value, of debt securities classified as held-to-maturity at June 30, 2015, is summarized as follows:

June 30, 2015	Amortized Cost	Fair Value
Within one year		
After one but within five years	$ 326	$ 330
After five but within ten years	176	180
After ten years	6,867	6,909
	7,369	7,419
Mortgage-backed securities	6,257	6,685
Total	$ 13,626	$ 14,104

Securities with a carrying value of $191,687 and $216,192 at June 30, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and repurchase agreements as required or permitted by law.

Securities and short-term investment activities are conducted with a diverse group of government entities, corporations and state and local municipalities. The counterparty s creditworthiness and type of collateral is evaluated on a case-by-case basis. At June 30, 2015 and December 31, 2014, there were no significant concentrations of credit risk from any one issuer, with the exception of U.S. Government agencies and sponsored enterprises that exceeded 10.0 percent of stockholders equity.

The fair value and gross unrealized losses of investment securities with unrealized losses for which an other-than-temporary impairment (OTTI) has not been recognized at June 30, 2015 and December 31, 2014, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, are summarized as follows:

June 30, 2015	Less Than 12 Months	12 Months or More	Total

	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	$ 10,044	$ 30			$ 10,044	$ 30
U.S. Government-sponsored enterprises	3,003	5			3,003	5
State and municipals:						
Taxable			$ 545	$ 22	545	22
Tax-exempt	44,196	636	786	30	44,982	666
Mortgage-backed securities:						
U.S. Government agencies	7,457	26	5,402	36	12,859	62
U.S. Government-sponsored enterprises	13,785	68	3,721	102	17,506	170
Total	$ 78,485	$ 765	$ 10,454	$ 190	$ 88,939	$ 955

Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

4. Investment securities (continued):

December 31, 2014	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government-sponsored enterprises	$ 21,228	$ 33	$ 7,954	$ 49	$ 29,182	$ 82
State and municipals:						
Taxable			544	26	544	26
Tax-exempt	4,702	23	2,423	39	7,125	62
Mortgage-backed securities:						
U.S. Government agencies	20,148	167			20,148	167
U.S. Government-sponsored enterprises	22,870	226			22,870	226
Total	$ 68,948	$ 449	$ 10,921	$ 114	$ 79,869	$ 563

The Company had 110 investment securities, consisting of 84 tax-exempt state and municipal obligations, two U.S. Treasury Securities, one taxable state and municipal obligation, one U.S. Government-sponsored enterprise securities, and 22 mortgage-backed securities that were in unrealized loss positions at June 30, 2015. Of these securities, one taxable state and municipal obligation, six mortgage-backed securities and three tax-exempt state and municipal securities were in a continuous unrealized loss position for twelve months or more. Management does not consider the unrealized losses on the debt securities, as a result of changes in interest rates, to be OTTI based on historical evidence that indicates the cost of these securities is recoverable within a reasonable period of time in relation to normal cyclical changes in the market rates of interest. Moreover, because there has been no material change in the credit quality of the issuers or other events or circumstances that may cause a significant adverse impact on the fair value of these securities, and management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis, which may be maturity, the Company does not consider the unrealized losses to be OTTI at June 30, 2015. There was no OTTI recognized for the three or six months ended June 30, 2015 and 2014.

The Company had 52 investment securities, consisting of 16 tax-exempt state and municipal obligations, one taxable state and municipal obligation, nine U.S. Government-sponsored enterprise securities and 26 mortgage-backed securities that were in unrealized loss positions at December 31, 2014. Of these securities, two U.S. Government-sponsored enterprise securities, four tax-exempt state and municipal securities, and one taxable state and municipal obligation were in a continuous unrealized loss position for twelve months or more.

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses:

The major classifications of loans outstanding, net of deferred loan origination fees and costs at June 30, 2015 and December 31, 2014 are summarized as follows. Net deferred loan costs were $700 and $651 at June 30, 2015 and December 31, 2014.

	June 30, 2015	December 31, 2014
Commercial	$ 322,418	$ 319,590
Real estate:		
Commercial	511,835	493,481
Residential	312,567	310,667
Consumer	84,721	86,156
Total	$ 1,231,541	$ 1,209,894

The changes in the allowance for loan losses account by major classification of loan for the three and six months ended June 30, 2015 and 2014 are summarized as follows:

		Real estate			
June 30, 2015	**Commercial**	**Commercial**	**Residential**	**Consumer**	**Total**
Allowance for loan losses:					
Beginning Balance April 1, 2015	$ 2,420	$ 3,087	$ 3,909	$ 1,387	$ 10,803
Charge-offs	(3)	(30)	(35)	(106)	(174)
Recoveries	3	5	3	38	49
Provisions	15	128	150	457	750
Ending balance	$ 2,435	$ 3,190	$ 4,027	$ 1,776	$ 11,428

		Real estate			
June 30, 2015	**Commercial**	**Commercial**	**Residential**	**Consumer**	**Total**
Allowance for loan losses:					
Beginning Balance January 1, 2015	$ 2,321	$ 3,037	$ 3,690	$ 1,290	$ 10,338
Charge-offs	(40)	(79)	(234)	(186)	(539)
Recoveries	64	6	8	51	129

Provisions	90	226	563	621	1,500
Ending balance	$ 2,435	$ 3,190	$ 4,027	$ 1,776	$ 11,428

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Peoples Financial Services Corp.

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(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

		Real estate			
June 30, 2014	**Commercial**	**Commercial**	**Residential**	**Consumer**	**Total**
Allowance for loan losses:					
Beginning Balance April 1, 2014	$ 1,961	$ 2,473	$ 3,248	$ 1,177	$ 8,859
Charge-offs	(29)	(404)	(270)	(87)	(790)
Recoveries	1	269	35	47	352
Provisions	268	337	445	151	1,201
Ending balance	$ 2,201	$ 2,675	$ 3,458	$ 1,288	$ 9,622

		Real estate			
June 30, 2014	**Commercial**	**Commercial**	**Residential**	**Consumer**	**Total**
Allowance for loan losses:					
Beginning Balance January 1, 2014	$ 2,008	$ 2,394	$ 3,135	$ 1,114	$ 8,651
Charge-offs	(376)	(432)	(510)	(155)	(1,473)
Recoveries	1	269	38	78	386
Provisions	568	444	795	251	2,058
Ending balance	$ 2,201	$ 2,675	$ 3,458	$ 1,288	$ 9,622

The allocation of the allowance for loan losses and the related loans by major classifications of loans at June 30, 2015 and December 31, 2014 is summarized as follows:

		Real estate				
June 30, 2015	**Commercial**	**Commercial**	**Residential**	**Consumer**	**Unallocated**	**Total**
Allowance for loan losses:						
Ending balance	$ 2,435	$ 3,190	$ 4,027	$ 1,776	$	$ 11,428
Ending balance: individually evaluated for impairment	1,209	1,338	796	137		3,480
Ending balance: collectively evaluated for impairment	1,226	1,745	3,231	1,639		7,841

Ending balance: loans acquired with deteriorated credit quality	$	$ 107	$	$		$ 107
Loans receivable:						
Ending balance	$ 322,418	$ 511,835	$ 312,567	$ 84,721	$	$ 1,231,541
Ending balance: individually evaluated for impairment	1,948	6,080	4,385	137		12,550
Ending balance: collectively evaluated for impairment	319,448	504,379	308,127	$ 84,584		1,216,538
Ending balance: loans acquired with deteriorated credit quality	$ 1,022	$ 1,376	$ 55		$	$ 2,453

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Peoples Financial Services Corp.

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(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

		Real estate				
December 31, 2014	**Commercial**	**Commercial**	**Residential**	**Consumer**	**Unallocated**	**Total**
Allowance for loan losses:						
Ending balance	$ 2,321	$ 3,037	$ 3,690	$ 1,290	$	$ 10,338
Ending balance: individually evaluated for impairment	1,072	805	767	38		2,682
Ending balance: collectively evaluated for impairment	1,081	2,125	2,921	1,252		7,379
Ending balance: loans acquired with deteriorated credit quality	$ 168	$ 107	$ 2			$ 277
Loans receivable:						
Ending balance	$ 319,590	$ 493,481	$ 310,667	$ 86,156	$	$ 1,209,894
Ending balance: individually evaluated for impairment	2,595	5,084	4,001	127		11,807
Ending balance: collectively evaluated for impairment	315,642	487,024	306,608	$ 86,029		1,195,303
Ending balance: loans acquired with deteriorated credit quality	$ 1,353	$ 1,373	$ 58		$	$ 2,784

The Company segments loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Loans are individually analyzed for credit risk by classifying them within the Company s internal risk rating system. The Company s risk rating classifications are defined as follows:

Pass- A loan to borrowers with acceptable credit quality and risk that is not adversely classified as Substandard, Doubtful, Loss nor designated as Special Mention.

Special Mention- A loan that has potential weaknesses that deserves management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution s credit position at some future date. Special Mention loans are not adversely classified since they do not expose the Company to sufficient risk to warrant adverse classification.

Substandard- A loan that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

Doubtful A loan classified as Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss- A loan classified as Loss is considered uncollectible and of such little value that its continuance as bankable loan is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

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(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

The following tables present the major classification of loans summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company s internal risk rating system at June 30, 2015 and December 31, 2014:

June 30, 2015	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 309,696	$ 6,171	$ 6,551	$	$ 322,418
Real estate:					
Commercial	486,289	13,280	12,266		511,835
Residential	301,962	1,865	8,740		312,567
Consumer	84,583		138		84,721
Total	$ 1,182,530	$ 21,316	$ 27,695	$	$ 1,231,541

December 31, 2014:	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 306,066	$ 6,135	$ 7,389	$	$ 319,590
Real estate:					
Commercial	472,270	9,858	11,353		493,481
Residential	300,299	2,123	8,245		310,667
Consumer	86,037	13	106		86,156
Total	$ 1,164,672	$ 18,129	$ 27,093	$	$ 1,209,894

Information concerning nonaccrual loans by major loan classification at June 30, 2015 and December 31, 2014 is summarized as follows:

	June 30, 2015	December 31, 2014
Commercial	$ 1,499	$ 1,322
Real estate:		

Commercial	3,468	3,732
Residential	3,881	3,523
Consumer	135	122
Total	$ 8,983	$ 8,699

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(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

The major classifications of loans by past due status are summarized as follows:

June 30, 2015	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
Commercial	$ 426	$ 61	$ 1,499	$ 1,986	$ 320,432	$ 322,418	
Real estate:							
Commercial	3,000	205	3,468	6,673	505,162	511,835	
Residential	1,098	1,708	4,611	7,417	305,150	312,567	$ 730
Consumer	654	232	477	1,363	83,358	84,721	342
Total	$ 5,178	$ 2,206	$ 10,055	$ 17,439	$ 1,214,102	$ 1,231,541	$ 1,072

December 31, 2014	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
Commercial	$ 898	$ 117	$ 1,322	$ 2,337	$ 317,253	$ 319,590	
Real estate:							
Commercial	2,100	888	3,868	6,856	486,625	493,481	$ 136
Residential	3,154	1,239	4,585	8,978	301,689	310,667	1,062
Consumer	848	247	547	1,642	84,514	86,156	425
Total	$ 7,000	$ 2,491	$ 10,322	$ 19,813	$ 1,190,081	$ 1,209,894	$ 1,623

The following tables summarize information concerning impaired loans as of and for the three and six months ended June 30, 2015 and June 30, 2014, and as of and for the year ended, December 31, 2014 by major loan classification:

	This Quarter	Year-to-Date

June 30, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance:							
Commercial	$ 1,658	$ 3,184		$ 1,989	$ 17	$ 2,168	$ 37
Real estate:							
Commercial	2,140	2,852		2,169	28	2,366	47
Residential	2,734	2,917		2,503	1	2,488	2
Consumer				6		26	
Total	6,532	8,953		6,667	46	7,048	86
With an allowance recorded:							
Commercial	1,312	1,312	$ 1,209	1,469	13	1,533	27
Real estate:							
Commercial	5,316	5,316	1,445	4,628	48	4,182	65
Residential	1,706	1,706	796	1,673	7	1,593	17
Consumer	137	137	137	114		91	
Total	8,471	8,471	3,587	7,884	68	7,399	109
Commercial	2,970	4,496	1,209	3,458	30	3,701	64
Real estate:							
Commercial	7,456	8,168	1,445	6,797	76	6,548	112
Residential	4,440	4,623	796	4,176	8	4,081	19
Consumer	137	137	137	120		117	
Total	$ 15,003	$ 17,424	$ 3,587	$ 14,551	$ 114	$ 14,447	$ 195

Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

December 31, 2014	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the Year Ended Average Recorded Investment	For the Year Ended Interest Income Recognized
With no related allowance:					
Commercial	$ 2,379	$ 4,084		$ 2,669	141
Real estate:					
Commercial	2,932	3,690		7,944	120
Residential	2,672	2,857		2,731	4
Consumer	83	83		94	
Total	8,066	10,714		13,438	265
With an allowance recorded:					
Commercial	1,569	1,569	$ 1,240	1,787	$ 58
Real estate:					
Commercial	3,525	3,525	912	2,293	28
Residential	1,387	1,387	769	590	10
Consumer	44	44	38	10	1
Total	6,525	6,525	2,959	4,680	97
Commercial	3,948	5,653	1,240	4,456	199
Real estate:					
Commercial	6,457	7,215	912	10,237	148
Residential	4,059	4,244	769	3,321	14
Consumer	127	127	38	104	1
Total	$ 14,591	$ 17,239	$ 2,959	$ 18,118	$ 362

June 30, 2014	Recorded Investment	Unpaid Principal Balance	Related Allowance	This Quarter Average Recorded Investment	This Quarter Interest Income Recognized	Year-to-Date Average Recorded Investment	Year-to-Date Interest Income Recognized

With no related allowance:							
Commercial	$ 2,649	$ 4,470		$ 2,329	$ 28	$ 2,908	$ 52
Real estate:							
Commercial	9,899	12,619		9,929	19	10,077	38
Residential	2,720	2,908		2,730	1	2,801	2
Consumer	97	97		113		111	
Total	15,365	20,094		15,101	48	15,897	92
With an allowance recorded:							
Commercial	1,757	1,757	$ 1,157	1,743	23	1,853	43
Real estate:							
Commercial	1,387	1,387	527	1,395	14	1,397	29
Residential	257	257	162	259		390	
Consumer							
Total	3,401	3,401	1,846	3,397	37	3,640	72
Commercial	4,406	6,227	1,157	4,072	51	4,761	95
Real estate:							
Commercial	11,286	14,006	527	11,324	33	11,474	67
Residential	2,977	3,165	162	2,989	1	3,191	2
Consumer	97	97		113		111	
Total	$ 18,766	$ 23,495	$ 1,846	$ 18,498	$ 85	$ 19,537	$ 164

Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

Included in the commercial loan and commercial and residential real estate categories are troubled debt restructurings that are classified as impaired. Troubled debt restructurings totaled $3,046 at June 30, 2015, $2,933 at December 31, 2014 and $1,900 at June 30, 2014.

Troubled debt restructured loans are loans with original terms, interest rate, or both, that have been modified as a result of a deterioration in the borrower s financial condition and a concession has been granted that the Company would not otherwise consider. Unless on nonaccrual, interest income on these loans is recognized when earned, using the interest method. The Company offers a variety of modifications to borrowers that would be considered concessions. The modification categories offered generally fall within the following categories:

Rate Modification - A modification in which the interest rate is changed to a below market rate.

Term Modification - A modification in which the maturity date, timing of payments or frequency of payments is changed.

Interest Only Modification - A modification in which the loan is converted to interest only payments for a period of time.

Payment Modification - A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

Combination Modification - Any other type of modification, including the use of multiple categories above. There were four loans modified as a troubled debt restructuring for the three months ended June 30, 2015, in the amount of $170. There were eight loans modified as troubled debt restructurings for the first six months ended June 30, 2015, in the amount of $554. There were no loans modified as troubled debt restructurings for the three or six months ended June 30, 2014. During the three and six months ended June 30, 2015 and 2014, there were no defaults on loans restructured within the last twelve months.

6. Other assets:

The components of other assets at June 30, 2015, and December 31, 2014 are summarized as follows:

	June 30, 2015	December 31, 2014
Other real estate owned	$ 334	$ 561
Investment in residential housing program	7,044	4,329
Mortgage servicing rights	566	676
Bank owned life insurance	30,374	29,983
Restricted equity securities	3,357	3,687
Other assets	14,785	13,830
Total	$ 56,460	$ 53,066

7. Fair value estimates:

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosure under GAAP. Fair value estimates are calculated without attempting to estimate the value of anticipated future business and the value of certain assets and liabilities that are not considered financial. Accordingly, such assets and liabilities are excluded from disclosure requirements.

Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

In accordance with FASB ASC 820, Fair Value Measurements and Disclosures, fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets. In many cases, these values cannot be realized in immediate settlement of the instrument.

Current fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction that is not a forced liquidation or distressed sale between participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with GAAP, the Company groups its assets and liabilities generally measured at fair value into three levels based on market information or other fair value estimates in which the assets and liabilities are traded or valued and the reliability of the assumptions used to determine fair value. These levels include:

Level 1: Unadjusted quoted prices of identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

An asset s or liability s placement in the fair value hierarchy is based on the lowest level of input that is significant to the fair value estimate.

The following methods and assumptions were used by the Company to calculate fair values and related carrying amounts of financial instruments:

Cash and cash equivalents: The carrying values of cash and cash equivalents as reported on the balance sheet approximate fair value.

Investment securities: The fair values of U.S. Treasury securities and marketable equity securities are based on quoted market prices from active exchange markets. The fair values of debt securities are based on pricing from a matrix pricing model.

Loans held for sale: The fair values of loans held for sale are based upon current delivery prices in the secondary mortgage market.

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(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

Net loans: For adjustable-rate loans that re-price frequently and with no significant credit risk, fair values are based on carrying values. The fair values of other non-impaired loans are estimated using discounted cash flow analysis, using interest rates currently offered in the market for loans with similar terms to borrowers of similar credit risk. Fair values for impaired loans are estimated using discounted cash flow analysis determined by the loan review function or underlying collateral values, where applicable.

In conjunction with the Merger, the loans purchased were recorded at their acquisition date fair value. In order to record the loans at fair value, management made three different types of fair value adjustments. A market rate adjustment was made to adjust for the movement in market interest rates, irrespective of credit adjustments, compared to the stated rates of the acquired loans. A credit adjustment was made on pools of homogeneous loans representing the changes in credit quality of the underlying borrowers from the loan inception to the acquisition date. The credit adjustment on distressed loans represents the portion of the loan balance that has been deemed uncollectible based on the management s expectations of future cash flows for each respective loan.

Mortgage servicing rights: To determine the fair value, the Company estimates the present value of future cash flows incorporating assumptions such as cost of servicing, discount rates, prepayment speeds and default rates.

Accrued interest receivable: The carrying value of accrued interest receivable as reported on the balance sheet approximates fair value.

Restricted equity securities: The carrying values of restricted equity securities approximate fair value, due to the lack of marketability for these securities.

Deposits: The fair values of noninterest-bearing deposits and savings, NOW and money market accounts are the amounts payable on demand at the reporting date. The fair value estimates do not include the benefit that results from such low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market. The carrying values of adjustable-rate, fixed-term time deposits approximate their fair values at the reporting date. For fixed-rate time deposits, the present value of future cash flows is used to estimate fair values. The discount rates used are the current rates offered for time deposits with similar maturities.

The fair value assigned to the core deposit intangible asset represents the future economic benefit of the potential cost savings from acquiring core deposits in the Merger compared to the cost of obtaining alternative funding such as brokered deposits from market sources. Management utilized an income valuation approach to present value the estimated future cash savings in order to determine the fair value of the intangible asset.

Short-term borrowings: The carrying values of short-term borrowings approximate fair value.

Long-term debt: The fair value of fixed-rate long-term debt is based on the present value of future cash flows. The discount rate used is the current rate offered for long-term debt with the same maturity.

Accrued interest payable: The carrying value of accrued interest payable as reported on the balance sheet approximates fair value.

Off-balance sheet financial instruments:

The majority of commitments to extend credit, unused portions of lines of credit and standby letters of credit carry current market interest rates if converted to loans. Because such commitments are generally unassignable of either the Company or the borrower, they only have value to the Company and the borrower. None of the commitments are subject to undue credit risk. The estimated fair values of off-balance sheet financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. The fair value of off-balance sheet financial instruments was not material at June 30, 2015 and December 31, 2014.

Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

Assets and liabilities measured at fair value on a recurring basis at June 30, 2015 and December 31, 2014 are summarized as follows:

		Fair Value Measurement Using		
June 30, 2015	**Amount**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
U.S. Treasury securities	$ 30,685	$ 30,685		$
U.S. Government-sponsored enterprises	85,862		$ 85,862	
State and Municipals:				
Taxable	16,712		16,712	
Tax-exempt	112,514		112,514	
Corporate debt securities				
Mortgage-backed securities:				
U.S. Government agencies	33,089		33,089	
U.S. Government-sponsored enterprises	39,928		39,928	
Total	$ 318,790	$ 30,685	$ 288,105	$

		Fair Value Measurement Using		
December 31, 2014	**Amount**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
U.S. Treasury securities	$ 48,550	$ 48,550		$

U.S. Government-sponsored enterprises	96,245		$ 96,245	
State and Municipals:				
Taxable	17,407		17,407	
Tax-exempt	92,901		92,901	
Corporate debt securities				
Mortgage-backed securities:				
U.S. Government agencies	37,476		37,476	
U.S. Government-sponsored enterprises	47,007		47,007	
Total	$ 339,586	$ 48,550	$ 291,036	$

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Peoples Financial Services Corp.

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7. Fair value estimates (continued):

Assets and liabilities measured at fair value on a nonrecurring basis at June 30, 2015 and December 31, 2014 are summarized as follows:

		Fair Value Measurement Using		
June 30, 2015	**Amount**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans	$ 6,448			$ 6,448
Other real estate owned	$ 88			$ 88

		Fair Value Measurement Using		
December 31, 2014	**Amount**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans	$ 4,414			$ 4,414
Other real estate owned	$ 218			$ 218

Fair values of impaired loans are based on the present value of expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral if the loan is collateral dependent.

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

		Quantitative Information about Level 3 Fair Value Measurements		
June 30, 2015	**Fair Value Estimate**	**Valuation Techniques**	**Unobservable Input**	**Range (Weighted Average)**
Impaired loans	$ 6,448	Appraisal of collateral	Appraisal adjustments	14.0% to 63.0% (24.2%)
			Liquidation expenses	3.0% to 6.0% (5.4%)
Other real estate owned	$ 88	Appraisal of collateral	Appraisal adjustments	20.0% to 73.5% (53.4%)
			Liquidation expenses	3.0% to 6.0% (5.0%)

		Quantitative Information about Level 3 Fair Value Measurements		
December 31, 2014	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Impaired loans	$ 4,414	Appraisal of collateral	Appraisal adjustments	2.6% to 61.1% (24.5%)
			Liquidation expenses	3.0% to 6.0% (5.5%)
Other real estate owned	$ 218	Appraisal of collateral	Appraisal adjustments	19.7% to 47.8% (30.5%)
			Liquidation expenses	3.0% to 6.0% (5.0%)

Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 Inputs which are not identifiable.

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

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(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

The carrying and fair values of the Company s financial instruments at June 30, 2015 and December 31, 2014 and their placement within the fair value hierarchy are as follows:

			Fair Value Hierarchy		
June 30, 2015	**Carrying Value**	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (level 1)**	**Significant Other Observable Inputs (level 2)**	**Significant Unobservable Inputs (Level 3)**
Financial assets:					
Cash and cash equivalents	$ 35,557	$ 35,557	$ 35,557		
Investment securities:					
Available-for-sale	318,790	318,790	$ 30,685	$ 288,105	
Held-to-maturity	13,626	14,104		14,104	
Loans held for sale	2,879	2,883		2,883	
Net loans	1,220,113	1,229,055			$ 1,229,055
Accrued interest receivable	5,507	5,507		5,507	
Mortgage servicing rights	566	1,227		1,227	
Restricted equity securities	3,357	3,357		3,357	
Total	$ 1,600,395	$ 1,610,480			
Financial liabilities:					
Deposits	$ 1,424,767	$ 1,425,821		1,425,821	
Short-term borrowings	25,860	25,860		25,860	
Long-term debt	31,663	33,145		33,145	
Accrued interest payable	443	443		$ 443	
Total	$ 1,482,733	$ 1,485,269			

Fair Value Hierarchy

December 31, 2014	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (level 1)	Significant Other Observable Inputs (level 2)	Significant Unobservable Inputs (Level 3)
Financial assets:					
Cash and cash equivalents	$ 31,426	$ 31,426	$ 31,426		
Investment securities:					
Available-for-sale	339,586	339,586	$ 48,550	$ 291,036	
Held-to-maturity	14,665	15,215		15,215	
Loans held for sale	3,486	3,492		3,492	
Net loans	1,199,556	1,210,369			$ 1,210,369
Accrued interest receivable	5,580	5,580		5,580	
Mortgage servicing rights	676	1,466		1,466	
Restricted equity securities	3,687	3,687		3,687	
Total	$ 1,598,662	$ 1,610,821			
Financial liabilities:					
Deposits	$ 1,425,558	$ 1,427,081		1,427,081	
Short-term borrowings	19,557	19,557		19,557	
Long-term debt	33,140	34,772		34,772	
Accrued interest payable	574	574		$ 574	
Total	$ 1,478,829	$ 1,481,984			

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(Dollars in thousands, except per share data)

8. Employee benefit plans:

The Company provides an Employee Stock Ownership Plan (ESOP) and a Retirement Profit Sharing Plan. The Company also maintains a Supplemental Executive Retirement Plan (SERP), an Employees Pension Plan, which is currently frozen, and a Postretirement Plan Life Insurance plan which was curtailed in 2013.

For the three and six months ended June 30, salaries and employee benefits expense includes approximately $173 and $452 in 2015 and $584 and $834 in 2014 relating to the employee benefit plans.

Components of net periodic benefit cost are as follows:

	Pension Benefits	
Three months ended June 30,	**2015**	**2014**
Net periodic pension cost:		
Service cost		
Interest cost	$ 174	$ 169
Expected return on plan assets	(233)	(227)
Amortization of prior service cost		
Amortization of unrecognized net loss	50	23
Net periodic pension cost	$ (9)	$ (35)

	Pension Benefits	
Six months ended June 30,	**2015**	**2014**
Net periodic pension cost:		
Service cost		
Interest cost	$ 348	$ 338
Expected return on plan assets	(466)	(454)
Amortization of prior service cost		
Amortization of unrecognized net loss	100	46
Net periodic pension cost	$ (18)	$ (70)

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

The following discussion and analysis should be read in conjunction with the unaudited consolidated interim financial statements contained in Part I, Item 1 of this report, and with our audited consolidated financial statements and

Management s Discussion and Analysis of Financial Condition and Results of Operations presented in our Annual Report on Form 10-K for the year ended December 31, 2014.

Cautionary Note Regarding Forward-Looking Statements:

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to risks and uncertainties. These statements are based on assumptions and may describe future plans, strategies and expectations of Peoples Financial Services Corp. and its direct and indirect subsidiaries. These forward-looking statements are generally identified by use of the words believe, expect, intend, anticipate, estimate, project or similar expressions. All statements in report, other than statements of historical facts, are forward-looking statements.

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Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Important factors that could cause our actual results to differ materially from those in the forward-looking statements include, but are not limited to: our ability to achieve the intended benefits of the 2013 merger with Penseco Financial Services Corporation; changes in interest rates; economic conditions, particularly in our market area; legislative and regulatory changes and the ability to comply with the significant laws and regulations governing the banking and financial services business; monetary and fiscal policies of the U.S. government, including policies of the U.S. Department of Treasury and the Federal Reserve System; credit risk associated with lending activities and changes in the quality and composition of our loan and investment portfolios; demand for loan and other products; deposit flows; competition; changes in the values of real estate and other collateral securing the loan portfolio, particularly in our market area; changes in relevant accounting principles and guidelines; and inability of third party service providers to perform. Additional factors that may affect our results are discussed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014, and in reports we file with the Securities and Exchange Commission from time to time.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, Peoples Financial Services Corp. does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Notes to the Consolidated Financial Statements referred to in the Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) are incorporated by reference into the MD&A. Certain prior period amounts may have been reclassified to conform with the current year s presentation. Any reclassifications did not have any effect on the operating results or financial position of the Company.

Critical Accounting Policies:

Disclosure of our significant accounting policies are included in Note 1 to the consolidated financial statements of the Annual Report on Form 10-K for the year ended December 31, 2014. Some of these policies are particularly sensitive requiring significant judgments, estimates and assumptions.

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Operating Environment:

With no new fiscal policy initiatives enacted during the second quarter of 2015, the focus of the Federal Open Market Committee (FOMC) was limited to issuing policy statements regarding the state of the economy. The FOMC noted improvement in labor markets, housing and household spending. Despite improvement to the unemployment rate, the historically low work force participation rate and slow wage growth continue to be a drag on the economy. The Federal Reserve s estimate for the gross domestic product (GDP), the value of all goods and services produced in the Nation, was downgraded to 1.8% to 2.0% for 2015. GDP rebounded in the second quarter of 2015 to a seasonally adjusted growth rate of 2.3%, comparable with the 2.4% experienced in 2014. The consumer price index (CPI) increased 3.2% annualized during the second quarter of 2015. Expectations are that the FOMC will begin to raise the federal funds rate starting late in the third quarter of 2015.

Review of Financial Position:

Total assets increased $6,086, or 0.7% annualized, to $1,747,755 at June 30, 2015, from $1,741,669 at December 31, 2014. Loans, net increased to $1,231,541 at June 30, 2015, compared to $1,209,894 at December 31, 2014, an increase of $21,647 or 3.6% annualized. The increase in loans, net during 2015 has been directly correlated to a decrease in investment securities available-for-sale. Investment securities decreased $21,835 or 6.2% in the first six months of 2015. Interest-bearing deposits increased $15,884, while noninterest-bearing deposits decreased $16,675. Total stockholders equity increased $3,625 or at an annual rate of 3.0%, from $246,779 at year-end 2014 to $250,404 at June 30, 2015. Compared to March 31, 2015, total assets increased $33,794 or 2.0% while loans, net decreased $5,627 or 0.5% and deposits increased $8,489 or 0.6%. For the six months ended June 30, 2015, total assets averaged $1,718,850, an increase of $17,059 from $1,701,791 for the same period of 2014.

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Investment Portfolio:

The majority of the investment portfolio is held as available-for-sale, which allows for greater flexibility in using the investment portfolio for liquidity purposes by allowing securities to be sold when market opportunities occur. Investment securities available-for-sale totaled $318,790 at June 30, 2015, a decrease of $20,796, or 6.1% from $339,586 at December 31, 2014. The decrease was primarily a result of the sale of U.S. Treasury securities in response to changes in the slope of the yield curve and in order to fund loan demand. Investment securities held-to-maturity totaled $13,626 at June 30, 2015, a decrease of $1,039 or 7.1% from $14,665 at December 31, 2014 due to payments received from mortgage backed holdings. For the three months ended June 30, 2015, total investments increased $37,944 resulting primarily from the purchase of short-term U.S. Treasury securities.

For the six months ended June 30, 2015, the investment portfolio averaged $310,481, a decrease of $9,971 or 3.1% compared to $320,452 for the same period last year. The tax-equivalent yield on the investment portfolio decreased 3 basis points to 2.76% for the six months ended June 30, 2015, from 2.79% for the comparable period of 2014. The yield decline is the result of decreasing reinvestment yields. The tax-equivalent yield decreased from 2.78% in the first quarter of 2015 to 2.74% in the second quarter of 2015.

Securities available-for-sale are carried at fair value, with unrealized gains or losses net of deferred income taxes reported in the accumulated other comprehensive income (loss) component of stockholders equity. We reported net unrealized holding gains, included as a separate component of stockholders equity of $3,099, net of deferred income taxes of $1,669, at June 30, 2015, and $4,090, net of deferred income taxes of $2,202, at December 31, 2014.

The Asset/Liability Committee (ALCO) reviews the performance and risk elements of the investment portfolio monthly. Through active balance sheet management and analysis of the securities portfolio, we endeavor to maintain sufficient liquidity to satisfy depositor requirements and meet the credit needs of our customers.

Loan Portfolio:

Following two consecutive quarters of strong loan growth in the fourth quarter of 2014 and first quarter of 2015, loans, net decreased slightly in the second quarter of 2015, but maintained an increase during the six month period. Loans, net increased to $1,231,541 at June 30, 2015 from $1,209,894 at December 31, 2014, an increase of $21,647 or 3.6% annualized. The growth reflected increases in commercial loans, commercial real estate loans and residential real estate loans, partially offset by a decrease in consumer loans. Commercial loans increased $2,828, or 1.8% annualized, to $322,418 at June 30, 2015 compared to $319,590 at December 31, 2014. Commercial real estate loans increased $18,354 or 7.5% annualized, to $511,835 at June 30, 2015 compared to $493,481 at December 31, 2014. Residential real estate loans increased $1,900, or 1.2% on an annualized basis, to $312,567 at June 30, 2015 compared to $310,667 at December 31, 2014.

The second quarter included the reclassification of $11,780 in loans previously classified as consumer into residential real estate loans based on the underlying collateral of the loans. Consumer loans decreased $1,435, or 3.4% on an

annualized basis, to $84,721 at June 30, 2015 compared to $86,156 at December 31, 2014. For the quarter ended June 30, 2015, loans, net in aggregate decreased $5,627.

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(Dollars in thousands, except per share data)

For the six months ended June 30, 2015, loans, net averaged $1,230,623, an increase of $46,082 or 3.9% compared to $1,184,541 for the same period of 2014. The tax-equivalent yield on the loan portfolio was 4.66% for the six months ended June 30, 2015, a 26 basis point decrease from the comparable period last year. Loan interest income in the first six months of 2015 and 2014, which we recognized as a result of the 2013 Penseco merger, were $347 and $1,430. As a result, the tax-equivalent yield on the loan portfolio would have decreased 10 basis points comparing the six month ended June 30, 2015 and 2014. The tax-equivalent yield on the loan portfolio decreased 8 basis points in the second quarter of 2015 from 4.71% in the second quarter of 2014. The tax-equivalent yield decreased 7 basis points comparing the first and second quarters of 2015.

In addition to the risks inherent in our loan portfolio, in the normal course of business, we are also a party to financial instruments with off-balance sheet risk to meet the financing needs of our customers. These instruments include legally binding commitments to extend credit, unused portions of lines of credit and commercial letters of credit made under the same underwriting standards as on-balance sheet instruments, and may involve, to varying degrees, elements of credit risk and interest rate risk (IRR) in excess of the amount recognized in the financial statements.

Unused commitments at June 30, 2015, totaled $284,352, consisting of $261,135 in unfunded commitments of existing loan facilities and $23,217 in standby letters of credit. Due to fixed maturity dates, specified conditions within these instruments, and the ultimate needs of our customers, many will expire without being drawn upon. We believe that amounts actually drawn upon can be funded in the normal course of operations and therefore, do not represent a significant liquidity risk to us. In comparison, unused commitments, at December 31, 2014, totaled $266,570, consisting of $235,961 in unfunded commitments of existing loans and $30,609 in standby letters of credit.

Asset Quality:

National, Pennsylvania, New York and market area unemployment rates at June 30, 2015 and 2014, are summarized as follows:

	June 30, 2015	**June 30, 2014**
United States	5.3%	6.1%
Pennsylvania (statewide)	5.5%	6.0%
Lackawanna County	5.9%	6.7%
Lehigh County	5.6%	6.2%
Luzerne County	6.5%	7.3%
Monroe County	6.8%	7.4%
Susquehanna County	5.4%	5.7%
Wayne County	5.4%	5.8%
Wyoming County	6.2%	6.7%
New York (statewide)	5.3%	6.2%

Broome County	5.8%	6.4%

The employment conditions improved for the Nation, Pennsylvania, New York as well as all seven counties representing our market areas in Pennsylvania and New York from one year ago. Despite the overall improvements, employment conditions continued to be weak as unemployment rates remained elevated relative to historical levels.

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Our asset quality improved in the second quarter of 2015. Nonperforming assets decreased $334 or 3.1% to $10,549 at June 30, 2015, from $10,883 at December 31, 2014. We experienced an increase in nonaccrual and restructured loans, which was more than offset by declines in accruing loans past due 90 days or more and other real estate owned. As a percentage of loans, net and foreclosed assets, nonperforming assets equaled 0.86% at June 30, 2015 compared to 0.90% at December 31, 2014.

Loans on nonaccrual status increased $284 to $8,983 at June 30, 2015 from $8,699 at December 31, 2014. The majority of the increase from year end was due to an increase of $358 in residential real estate loans and an increase of $177 in commercial loans on nonaccrual status. Commercial real estate loans on nonaccrual status decreased $264 while consumer loans on nonaccrual status increased $13. Other real estate owned decreased $227 to $334 at June 30, 2015 from $561 at December 31, 2014.

For the three months ended June 30, 2015, nonperforming assets improved to $10,549, a decrease of $748 from $11,297 at March 31, 2015. Decreases in nonaccrual and restructured loans of $593 and accruing loans past due 90 days or more of $165 more than offset a $10 increase in other real estate owned.

Generally, maintaining a high loan to deposit ratio is our primary goal in order to maximize profitability. However, this objective is superseded by our attempts to assure that asset quality remains strong. We continued our efforts to maintain sound underwriting standards for both commercial and consumer credit. Most commercial lending is done primarily with locally owned small businesses.

We maintain the allowance for loan losses at a level we believe adequate to absorb probable credit losses related to specifically identified loans, as well as probable incurred loan losses inherent in the remainder of the loan portfolio as of the balance sheet date. The allowance for loan losses is based on past events and current economic conditions. We employ the Federal Financial Institutions Examination Council Interagency Policy Statement, as amended December 13, 2006, and GAAP in assessing the adequacy of the allowance account. Under GAAP, the adequacy of the allowance account is determined based on the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 310, Receivables, for loans specifically identified to be individually evaluated for impairment and the requirements of FASB ASC 450, Contingencies, for large groups of smaller-balance homogeneous loans to be collectively evaluated for impairment.

We follow our systematic methodology in accordance with procedural discipline by applying it in the same manner regardless of whether the allowance is being determined at a high point or a low point in the economic cycle. Each quarter, loan review identifies those loans to be individually evaluated for impairment and those loans collectively evaluated for impairment utilizing a standard criteria. Internal loan review grades are assigned quarterly to loans identified to be individually evaluated. A loan s grade may differ from period to period based on current conditions and events, however, we consistently utilize the same grading system each quarter. We consistently use loss experience from the latest twelve quarters in determining the historical loss factor for each pool collectively evaluated for impairment. Qualitative factors are evaluated in the same manner each quarter and are adjusted within a relevant range of values based on current conditions. For additional disclosure related to the allowance for loan losses refer to the

note entitled, Loans, net and Allowance for Loan Losses, in the Notes to Consolidated Financial Statements to this Quarterly Report.

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The allowance for loan losses increased $1,090 to $11,428 at June 30, 2015, from $10,338 at the end of 2014. For the six months ended June 30, 2015, net charge-offs were $410 or 0.07% of average loans outstanding, a $677 decrease compared to $1,087 or 0.19% of average loans outstanding in the same period of 2014. Net charge-offs were $125 or 0.04% of average loans outstanding in the second quarter of 2015, a $313 decrease compared to $438 or 0.15% of average loans outstanding in the second quarter of 2014.

Deposits:

We attract the majority of our deposits from within our eight county market area that stretches from the Lehigh Valley in Pennsylvania to Broome County in the Southern Tier of New York State through the offering of various deposit instruments including demand deposit accounts, NOW accounts, money market deposit accounts, savings accounts, and time deposits, including certificates of deposit and IRA s. For the six months ended June 30, 2015, total deposits decreased slightly to $1,424,767 from $1,425,558 at December 31, 2014. Growth was experienced in savings accounts and interest-bearing transaction accounts while the other classifications declined. Interest-bearing transaction accounts, including NOW and money market accounts, increased $14,831, or 6.6% annualized, to $467,197 at June 30, 2015, from $452,366 at December 31, 2014. Savings deposits increased $8,035, or 4.1% annualized, to $399,987 at June 30, 2015, from $391,952 at December 31, 2014. All other deposit categories decreased in the first six months of 2015 due to cyclical trends. Demand deposits, decreased $16,675, or 10.7% annualized, to $296,823 at June 30, 2015, compared to $313,498 at December 31, 2014. Time deposits less than $100 decreased $626, or 0.7% annualized, while time deposits of $100 or more declined $6,356, or 16.9% annualized.

For the three months ended June 30, 2015, total deposits increased $8,489 or 2.4% annualized. Growth in interest-bearing and noninterest-bearing demand deposits, as well as time deposits less than $100, more than offset declines in demand deposits, savings deposits and time deposits of $100 or more.

For the six months ended June 30, 2015 interest-bearing deposits averaged $1,116,900 in 2015 compared to $1,113,621 in 2014. The cost of interest-bearing deposits was 0.44% in 2015 compared to 0.50% for the same period last year. For the first six months, the overall cost of interest-bearing liabilities including the cost of borrowed funds, was 0.52% in 2015 compared to 0.59% in 2014. The cost of interest-bearing liabilities decreased 4 basis points when comparing the first and second quarters of 2015.

Interest rates have been at historic lows for an extended period. Short term and core deposit rates have remained flat. As such, deposits have been attracted by offering rates on longer term time deposit products and core savings accounts which are higher than other investment alternatives available to customers elsewhere in the market place.

Borrowings:

The Bank utilizes borrowings as a secondary source of liquidity for its asset/liability management. Advances are available from the Federal Home Loan Bank of Pittsburgh (FHLB) provided certain standards related to credit worthiness have been met. Repurchase and term agreements are also available from the FHLB.

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Total short-term borrowings at June 30, 2015, totaled $25,860 compared to $19,557 at December 31, 2014, an increase of $6,303. Long-term debt was $31,663 at June 30, 2015, compared to $33,140 at year end 2014. The reduction was a product of monthly contractual amortized payments made during the six months ended June 30, 2015.

Market Risk Sensitivity:

Market risk is the risk to our earnings or financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. Our exposure to market risk is primarily IRR associated with our lending, investing and deposit-gathering activities. During the normal course of business, we are not exposed to foreign exchange risk or commodity price risk. Our exposure to IRR can be explained as the potential for change in our reported earnings and/or the market value of our net worth. Variations in interest rates affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. Interest rate changes also affect the underlying economic value of our assets, liabilities and off-balance sheet items. These changes arise because the present value of future cash flows, and often the cash flows themselves, change with interest rates. The effects of the changes in these present values reflect the change in our underlying economic value and provide a basis for the expected change in future earnings related to interest rates. IRR is inherent in the role of banks as financial intermediaries. However, a bank with a high degree of IRR may experience lower earnings, impaired liquidity and capital positions, and most likely, a greater risk of insolvency. Therefore, banks must carefully evaluate IRR to promote safety and soundness in their activities.

As a result of economic uncertainty and a prolonged era of historically low market rates, it has become challenging to manage IRR. Due to these factors, IRR and effectively managing it are very important to both bank management and regulators. Bank regulations require us to develop and maintain an IRR management program, overseen by the Board of Directors and senior management, that involves a comprehensive risk management process in order to effectively identify, measure, monitor and control risk. Should bank regulatory agencies identify a material weakness in our risk management process or high exposure relative to our capital, bank regulatory agencies may take action to remedy these shortcomings. Moreover, the level of IRR exposure and the quality of our risk management process is a determining factor when evaluating capital adequacy.

The ALCO, comprised of members of our Board of Directors, senior management and other appropriate officers, oversees our IRR management program. Specifically, ALCO analyzes economic data and market interest rate trends, as well as competitive pressures, and utilizes computerized modeling techniques to reveal potential exposure to IRR. This allows us to monitor and attempt to control the influence these factors may have on our rate-sensitive assets (RSA) and rate-sensitive liabilities (RSL), and overall operating results and financial position. One such technique utilizes a static gap model that considers repricing frequencies of RSA and RSL in order to monitor IRR. Gap analysis attempts to measure our interest rate exposure by calculating the net amount of RSA and RSL that reprice within specific time intervals. A positive gap occurs when the amount of RSA repricing in a specific period is greater than the amount of RSL repricing within that same time frame and is indicated by a RSA/RSL ratio greater than 1.0. A negative gap occurs when the amount of RSL repricing is greater than the amount of RSA and is indicated by a RSA/RSL ratio of less than 1.0. A positive gap implies that earnings will be impacted favorably if interest rates rise

and adversely if interest rates fall during the period. A negative gap tends to indicate that earnings will be affected inversely to interest rate changes.

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Our cumulative one-year RSA/RSL ratio equaled 2.01% at June 30, 2015. Given the length of time that market rates have been at historical lows and the potential for rates to increase in the future, the focus of ALCO has been to create a positive static gap position. With regard to RSA, we predominantly offer medium- term, fixed-rate loans as well as adjustable rate loans. With respect to RSL, we offer longer term promotional certificates of deposit in an attempt to increase duration. The current position at June 30, 2015, indicates that the amount of RSA repricing within one year would exceed that of RSL, thereby causing increases in market rates, to increase net interest income. However, these forward-looking statements are qualified in the aforementioned section entitled Forward-Looking Discussion in this Management s Discussion and Analysis.

Static gap analysis, although a standard measuring tool, does not fully illustrate the impact of interest rate changes on future earnings. First, market rate changes normally do not equally or simultaneously affect all categories of assets and liabilities. Second, assets and liabilities that can contractually reprice within the same period may not do so at the same time or to the same magnitude. Third, the interest rate sensitivity table presents a one-day position. Variations occur daily as we adjust our rate sensitivity throughout the year. Finally, assumptions must be made in constructing such a table.

As the static gap report fails to address the dynamic changes in the balance sheet composition or prevailing interest rates, we utilize a simulation model to enhance our asset/liability management. This model is used to create pro forma net interest income scenarios under various interest rate shocks. Model results at June 30, 2015, produced results similar to those indicated by the one-year static gap position. In addition, parallel and instantaneous shifts in interest rates under various interest rate shocks resulted in changes in net interest income that were well within ALCO policy limits. We will continue to monitor our IRR throughout 2015 and endeavor to employ deposit and loan pricing strategies and direct the reinvestment of loan and investment repayments in order to manage our IRR position.

Financial institutions are affected differently by inflation than commercial and industrial companies that have significant investments in fixed assets and inventories. Most of our assets are monetary in nature and change correspondingly with variations in the inflation rate. It is difficult to precisely measure the impact inflation has on us, however we believe that our exposure to inflation can be mitigated through asset/liability management.

Liquidity:

Liquidity management is essential to our continuing operations and enables us to meet financial obligations as they come due, as well as to take advantage of new business opportunities as they arise. Financial obligations include, but are not limited to, the following:

Funding new and existing loan commitments;

Payment of deposits on demand or at their contractual maturity;

Repayment of borrowings as they mature;

Payment of lease obligations; and

Payment of operating expenses.

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These obligations are managed daily, thus enabling us to effectively monitor fluctuations in our liquidity position and to adapt that position according to market influences and balance sheet trends. Future liquidity needs are forecasted and strategies are developed to ensure adequate liquidity at all times.

Historically, core deposits have been the primary source of liquidity because of their stability and lower cost, in general, than other types of funding. Providing additional sources of funds are loan and investment payments and prepayments and the ability to sell both available for sale securities and mortgage loans held for sale. We believe liquidity is adequate to meet both present and future financial obligations and commitments on a timely basis.

We employ a number of analytical techniques in assessing the adequacy of our liquidity position. One such technique is the use of ratio analysis to determine the extent of our reliance on noncore funds to fund our investments and loans maturing after June 30, 2015. Our noncore funds at June 30, 2015, were comprised of time deposits in denominations of $100 or more and other borrowings. These funds are not considered to be a strong source of liquidity since they are very interest rate sensitive and are considered to be highly volatile. At June 30, 2015, our net noncore funding dependence ratio, the difference between noncore funds and short-term investments to long-term assets, was 6.2%, while our net short-term noncore funding dependence ratio, noncore funds maturing within one-year, less short-term investments to long-term assets equaled 2.7%. Comparatively, our overall noncore dependence ratio improved from year-end 2014 when it was 8.5%. Similarly, our net short-term noncore funding dependence ratio was 3.0% at year-end, indicating that our reliance on noncore funds has decreased.

The Consolidated Statements of Cash Flows present the changes in cash and cash equivalents from operating, investing and financing activities. Cash and cash equivalents, consisting of cash on hand, cash items in the process of collection, deposit balances with other banks and federal funds sold, increased $4,131 during the six months ended June 30, 2015. Cash and cash equivalents increased $26,098 for the same period last year. For the six months ended June 30, 2015, net cash inflows of $8,867 from operating activities were partially offset by net cash outflows of $4,486 from investing activities and $250 from financing activities. For the same period of 2014, net cash inflows of $9,942 from operating activities and $29,195 from financing activities were partially offset by net cash outflows of $13,039 from investing activities.

Operating activities provided net cash of $8,867 for the six months ended June 30, 2015, and $9,942 for the corresponding six months of 2014. Net income, adjusted for the effects of gains and losses along with noncash transactions such as depreciation and the provision for loan losses, is the primary source of funds from operations.

Investing activities primarily include transactions related to our lending activities and investment portfolio. Investing activities used net cash of $4,486 for the six months ended June 30, 2015, compared to $13,039 for the same period of 2014. In 2015, an increase in lending activities was the primary factor causing the net cash outflow from investing activities. Investment portfolio activities was the predominant factor causing the net cash outflow from investing activities in 2014.

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Financing activities used net cash of $250 for the six months ended June 30, 2015, and provided net cash of $29,195 for the corresponding six months of 2014. Deposit gathering is our predominant financing activity. During the six months ended June 30, 2015, deposits decreased compared to an increase in deposits during the same period last year. The net decrease in deposits totaled $424 in the six months ended June 30, 2015. Comparatively, deposit gathering provided net cash of $43,866 for the same period of 2014. We continued to attract deposits from new and existing customers, including municipalities and school districts, as well as deposits gathered in relation to natural gas activity within existing markets in Susquehanna and Wyoming Counties of Pennsylvania.

We believe that our future liquidity needs will be satisfied through maintaining an adequate level of cash and cash equivalents, by maintaining readily available access to traditional funding sources, and through proceeds received from the investment and loan portfolios. The current sources of funds will enable us to meet all cash obligations as they come due.

Capital:

Stockholders equity totaled $250,404 or $33.20 per share at June 30, 2015, compared to $246,779 or $32.69 per share at December 31, 2014. Net income of $9,475 for the six months ended June 30, 2015 was the primary factor leading to the improved capital position. Stockholders equity was also affected by cash dividends declared of $4,679, shares retired of $215, stock based compensation of $35, and an other comprehensive loss resulting from market value fluctuations in the investment portfolio of $991.

Dividends declared equaled $0.62 per share in 2015 and 2014. The dividend payout ratio was 49.2% for the six months ended June 30, 2015 and 58.5% for the same period of 2014. The merger agreement pursuant to which we merged with Penseco in 2013 contemplates that, unless 80 percent of our board of directors determines otherwise, we will pay a quarterly cash dividend in an amount no less than $0.31 per share through 2018, provided that sufficient funds are legally available, and that Peoples and Peoples Bank remain Well-capitalized in accordance with applicable regulatory guidelines. It is the intention of the Board of Directors to continue to pay cash dividends in the future. However, these decisions are affected by operating results, financial and economic decisions, capital and growth objectives, appropriate dividend restrictions and other relevant factors.

In July 2013, the Board of Directors of the FRB approved the Basel III interim final rule (Basel III) which is intended to strengthen the quality and increase the required level of regulatory capital for a more stable and resilient banking system. The changes include: (i) a new regulatory capital measure, Common Equity Tier 1 (CET1), which is limited to capital elements of the highest quality; (ii) a new definition and increase of tier 1 capital which is now comprised of CET1 and Additional Tier 1; (iii) changes in calculation of some risk-weighted assets and off-balance sheet exposure; and (iv) a capital conservation buffer that will limit capital distributions, stock redemptions, and certain discretionary bonus payments if the institution does not maintain capital in excess of the minimum capital requirements. These new capital rules took effect for our Bank on January 1, 2015 and reporting began with the March 31, 2015 call report.

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Peoples Financial Services Corp.

MANAGEMENT S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

The adequacy of capital is reviewed on an ongoing basis with reference to the size, composition and quality of resources and regulatory guidelines. We seek to maintain a level of capital sufficient to support existing assets and anticipated asset growth, maintain favorable access to capital markets, and preserve high quality credit ratings. At June 30, 2015, the Bank s Tier 1 capital to total average assets was 10.92% as compared to 10.42% at December 31, 2014. The Bank s Tier 1 capital to risk weighted asset ratio was 15.40% and the total capital to risk weighted asset ratio was 16.38% at June 30, 2015. These ratios were 14.28% and 15.15% at December 31, 2014. The Bank s common equity Tier 1 to risk weighted asset ratio was 15.40 at June 30, 2015. The Bank was deemed to be well-capitalized under regulatory standards at June 30, 2015.

Review of Financial Performance:

Net income for the second quarter of 2015 equaled $4,431 or $0.59 per share compared to $3,331 or $0.44 per share for the second quarter of 2014. Return on average assets (ROA) measures our net income in relation to total assets. Our ROA was 1.03% for the second quarter of 2015 compared to 0.78% for the same period of 2014. Return on average equity (ROE) indicates how effectively we can generate net income on the capital invested by stockholders. Our ROE was 7.14% for the second quarter of 2015 compared to 5.60% for the second quarter of 2014. The results for the three months ended June 30, 2014 included pre-tax acquisition related expenses of $1,008. Net income for the six months ended June 30, 2015 equaled $9,475 or $1.26 per share compared to $8,029 or $1.06 per share for the same period of 2014. Our ROA and ROE were 1.11% and 7.71% through six months in 2015 compared to 0.95% and 6.79% for the same period of 2014. Gains on sale of investment securities were $832 for the six months ended June 30, 2015 and $160 for the comparable period in 2014.

Net Interest Income:

Net interest income is the fundamental source of earnings for commercial banks. Fluctuations in the level of net interest income can have the greatest impact on net profits. Net interest income is defined as the difference between interest revenue, interest and fees earned on interest-earning assets, and interest expense, the cost of interest-bearing liabilities supporting those assets. The primary sources of earning assets are loans and investment securities, while interest-bearing deposits, short-term and long-term borrowings comprise interest-bearing liabilities. Net interest income is impacted by:

- Variations in the volume, rate and composition of earning assets and interest-bearing liabilities;
- Changes in general market rates; and
- The level of nonperforming assets.

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Changes in net interest income are measured by the net interest spread and net interest margin. Net interest spread, the difference between the average yield earned on earning assets and the average rate incurred on interest-bearing liabilities, illustrates the effects changing interest rates have on profitability. Net interest margin, net interest income as a percentage of earning assets, is a more comprehensive ratio, as it reflects not only the spread, but also the change in the composition of interest-earning assets and interest-bearing liabilities. Tax-exempt loans and investments carry pre-tax yields lower than their taxable counterparts. Therefore, in order to make the analysis of net interest income more comparable, tax-exempt income and yields are reported herein on a tax-equivalent basis using the prevailing federal statutory tax rate of 35.0% in 2015 and 2014.

For the three months ended June 30, tax-equivalent net interest income increased $479 to $14,947 in 2015 from $14,468 in 2014. The net interest spread increased to 3.72% for the three months ended June 30, 2015 from 3.58% for the three months ended June 30, 2014. The tax-equivalent net interest margin increased to 3.84% for the second quarter of 2015 from 3.73% for the comparable period of 2014. The tax-equivalent net interest margin for the first quarter of 2015 was 3.88%. Loan interest income in the second quarter of 2015 related to loans acquired in the 2013 Penseco merger was $122, resulting in an increase in the tax-equivalent net interest margin of 3 basis points. Comparatively, loan interest recognized on these loans in the second quarter of 2014 was $375 resulting in an increase in the tax-equivalent net interest margin of 10 basis points. Without such interest income, the tax equivalent net interest margin for the three months ended June 30 would have been 3.81% in 2015 and 3.63% in 2014.

For the three months ended June 30, tax-equivalent interest income on earning assets increased $200, to $16,395 in 2015 as compared to $16,195 in 2014. The increase was primarily due to the growth in average earning assets which increased $2,082, to $1,559,644 for the second quarter of 2015 from $1,557,562 for the same period in 2014. The overall yield on earning assets, on a fully tax-equivalent basis, increased 5 basis points for the three months ended June 30, 2015 at 4.22% as compared to 4.17% for the three months ended June 30, 2014. The increase in the yield on earning assets resulted from a shifting of volumes from lower yielding earning assets to loans. The overall yield earned on loans however, decreased 8 basis points for the second quarter of 2015 to 4.63% from 4.71% for the second quarter of 2014. Average loans increased to $1,235,423 for the quarter ended June 30, 2015 compared to $1,187,568 for the same period in 2014. The resulting tax-equivalent interest earned on loans was $14,268 for the three month period ended June 30, 2015 compared to $13,938 for the same period in 2014, an increase of $330.

Total interest expense decreased $279, to $1,448 for the three months ended June 30, 2015 from $1,727 for the three months ended June 30, 2014. A favorable volume variance caused the decrease. The average volume of interest bearing liabilities declined to $1,160,031 for the three months ended June 30, 2015, as compared to $1,172,286 for the three months ended June 30, 2014. The cost of funds decreased to 0.50% for the three months ended June 30, 2015 as compared to 0.59% for the same period in 2014.

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For the six months ended June 30, tax-equivalent net interest income decreased $227 to $29,774 in 2015 from $30,001 in 2014. The net interest spread decreased to 3.73% for the six months ended June 30, 2015 from 3.76% for the six months ended June 30, 2014. The tax-equivalent net interest margin for the six months ended June 30 was 3.86% in 2015 compared to 3.90% in 2014. Loan interest income in the six months ended June 30, 2015 related to loans acquired in the fourth quarter of 2013 was $347, resulting in an increase in the tax-equivalent net interest margin of 5 basis points. Comparatively, loan interest income on these loans recognized in the first six months of 2014 was $1,430 resulting in an increase in the tax-equivalent net interest margin of 19 basis points. Without such interest income, the tax equivalent net interest margin for the six months ended June 30 would have been 3.81% in 2015 and 3.71% in 2014.

For the six months ended June 30, 2015, tax-equivalent interest income decreased $658, to $32,757 as compared to $33,415 for the six months ended June 30, 2014. A volume variance in interest income of $2,176 attributable to changes in the average balance of earning assets was more than offset by a $2,834 unfavorable rate variance due to a reduction in the yield on earning assets. Specifically, the decrease was primarily due to declining yields on average earning assets which decreased 10 basis points for the first six months of 2015 from the same period in 2014. The overall yield on earning assets, on a fully tax-equivalent basis, decreased for the six months ended June 30, 2015 to 4.25% as compared to 4.35% for the six months ended June 30, 2014. This was a result of the continuation of the low interest rate environment along with increased market competition.

Total interest expense decreased $431 to $2,983 for the six months ended June 30, 2015 from $3,414 for the six months ended June 30, 2014. A favorable volume variance caused interest expenses to decrease $320. The average volume of interest bearing liabilities declined to $1,156,541 for the six months ended June 30, 2015, as compared to $1,169,541 for the six months ended June 30, 2014. The remaining $111 decrease in interest expense was attributable to a favorable rate variance. The cost of funds decreased to 0.52% for the six months ended June 30, 2015 as compared to 0.59% for the same period in 2014.

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Peoples Financial Services Corp.

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(Dollars in thousands, except per share data)

The average balances of assets and liabilities, corresponding interest income and expense and resulting average yields or rates paid are summarized as follows. Averages for earning assets include nonaccrual loans. Investment averages include available-for-sale securities at amortized cost. Income on investment securities and loans is adjusted to a tax equivalent basis using the prevailing federal statutory tax rate of 35%.

	Six months ended					
	June 2015			June 2014		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Assets:						
Earning assets:						
Loans						
Taxable	$ 1,159,462	$ 26,731	4.65%	$ 1,110,609	$ 27,159	4.93%
Tax exempt	71,161	1,737	4.92	73,932	1,757	4.79
Investments						
Taxable	212,617	1,731	1.64	219,716	1,900	1.74
Tax exempt	97,864	2,523	5.20	100,736	2,532	5.07
Interest bearing deposits	6,672	26	0.79	5,826	19	0.66
Federal funds sold	7,190	9	0.25	38,532	48	0.25
Total earning assets	1,554,966	32,757	4.25%	1,549,351	33,415	4.35%
Less: allowance for loan losses	(10,746)			(8,791)		
Other assets	174,630			161,231		
Total assets	$ 1,718,850			$ 1,701,791		
Liabilities and Stockholders Equity:						
Interest bearing liabilities:						
Money market accounts	197,354	340	0.35%	215,862	390	0.36%
NOW accounts	260,267	468	0.36	216,962	363	0.34
Savings accounts	401,521	443	0.22	369,471	529	0.29
Time deposits less than $100	169,378	892	1.06	215,041	1,050	0.98
Time deposits $100 or more	88,380	317	0.72	96,285	439	0.92
Short term borrowings	7,286	12	0.33	20,048	58	0.58
Long-term debt	32,355	511	3.18	35,872	585	3.28
Total interest bearing liabilities	1,156,541	2,983	0.52%	1,169,541	3,414	0.59%
Non-interest bearing demand deposits	299,518			281,337		

Other liabilities	14,848			12,556		
Stockholders equity	247,943			238,357		
Total liabilities and stockholders equity	$ 1,718,850			$ 1,701,791		
Net interest income/spread		$ 29,774	3.73%		$ 30,001	3.76%
Net interest margin			3.86%			3.90%
Tax-equivalent adjustments:						
Loans		$ 608			$ 615	
Investments		883			886	
Total adjustments		$ 1,491			$ 1,501	

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Provision for Loan Losses:

We evaluate the adequacy of the allowance for loan losses account on a quarterly basis utilizing our systematic analysis in accordance with procedural discipline. We take into consideration certain factors such as composition of the loan portfolio, volumes of nonperforming loans, volumes of net charge-offs, prevailing economic conditions and other relevant factors when determining the adequacy of the allowance for loan losses account. We make monthly provisions to the allowance for loan losses account in order to maintain the allowance at the appropriate level indicated by our evaluations. Based on our most current evaluation, we believe that the allowance is adequate to absorb any known and inherent losses in the portfolio as of June 30, 2015.

For the three and six months ended June 30, 2015, the provision for loan losses totaled $750 and $1,500, compared to $1,201 and $2,058 for those same periods in 2014. The decrease in nonperforming assets was the main contributor to the decreased provision for the quarter and year-to-date periods ended June 30, 2015.

Noninterest Income:

Noninterest income for the second quarter decreased $152 or 4.0% to $3,626 in 2015 from $3,778 in 2014. For the six months ended June 30, 2015, noninterest income totaled $7,935, an increase of $597 or 8.1% from $7,338 for the comparable period of 2014. Service charges, fees and commissions was relatively unchanged, decreasing $27 to $3,154 through six months in 2015 from $3,181 for the same period in 2014. Merchant services income decreased $29 to $1,753 for the six months ended June 30, 2015 from $1,782 for the same period last year as a result of lower transaction volumes and a decrease in the number of merchant accounts serviced. Income generated from commissions and fees on fiduciary activities decreased $169 to $946 for the six months ended June 30, 2015 in comparison to $1,115 for the same period in 2014 due to a decrease in executor fees settled in 2015. Income generated from our wealth management division increased $51 to $403 through the first six months of 2015 in comparison to $352 over that same period in 2014. Mortgage banking income increased $178 to $470 for the first six months of 2015 compared to $292 for the comparable period in 2014 as the volume of loans originated for sale improved. Life insurance investment income decreased $79 to $377 for the six months ended June 30, 2015 from $456 for the same period in 2014. Beginning late in the third quarter of 2014, we began to incur offsets to life insurance income that represent mortality costs to the life insurance. Those costs netted from income equaled $71 through the first six months of 2015. Gains from the sale of investment securities available-for-sale increased to $832 for the six months ended June 30, 2015 compared to $160 for the same period in 2014 as we took advantage of the significant improvement in the value of U.S. Treasury securities brought on by the reduction in market yields in the first quarter of 2015.

For the three months ended June 30, noninterest income decreased to $3,626 in 2015 from $3,778 in 2014. Increases in income from merchant services, wealth management and mortgage banking were more than offset by declines in service charges, fees and commissions, commissions and fees on fiduciary activities, life insurance income and net gains on sale of investment securities available-for-sale.

Peoples Financial Services Corp.

MANAGEMENT S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Noninterest Expenses:

In general, noninterest expense is categorized into three main groups: employee-related expenses, occupancy and equipment expenses and other expenses. Employee-related expenses are costs associated with providing salaries, including payroll taxes and benefits, to our employees. Occupancy and equipment expenses, the costs related to the maintenance of facilities and equipment, include depreciation, general maintenance and repairs, real estate taxes, rental expense offset by any rental income, and utility costs. Other expenses include general operating expenses such as advertising, contractual services, insurance, including FDIC assessment, other taxes and supplies. Several of these costs and expenses are variable while the remainder are fixed. We utilize budgets and other related strategies in an effort to control the variable expenses.

For the second quarter, noninterest expense decreased $728 or 6.0% to $11,511 in 2015 from $12,239 in 2014. For the six months ended June 30, 2015, noninterest expense decreased $921 or 3.9% to $22,605 in 2015 from $23,526 in 2014. Personnel costs increased 7.1%, net occupancy and equipment costs increased 13.7%, merchant services expense increased 11.6% and other expenses decreased by 10.5% comparing year-to-date 2015 and 2014.

Salaries and employee benefits expense, which comprise the majority of noninterest expense, totaled $5,613 for the second quarter of 2015, an increase of $652 or 13.1% when compared to the second quarter of 2014. Salaries and employee benefits expense totaled $10,846 for the six months ended June 30, 2015 compared to $10,129 for the same period of 2014, an increase of $717 or 7.1%. Severances paid out to eliminate certain duplicated positions in the first six months of 2015 totaled $405.

Merchant services expense increased $155 or 31.3% to $650 for the three months ended June 30, 2015 from $495 for the same period in 2014. Merchant services expense increased $123 or 11.6% to $1,183 for the six months ended June 30, 2015 from $1,060 for the year earlier period. Both the quarterly and six month results were a product of higher interchange fees being paid to the service providers.

We experienced a $178 or 7.7% decrease in net occupancy and equipment expense comparing the second quarters of 2015 at $2,149 and 2014 at $2,327. Net occupancy and equipment expense increased $557 or 13.7% comparing the six months ended June 30, 2015 at $4,617 and June 30, 2014 at $4,060. The increase in net occupancy and equipment expense was caused by costs associated with the Lehigh Valley branch during 2015, which had no comparable expense in the corresponding period in 2014, and costs associated with snow removal and clean up to the 26 locations due to the severe winter.

For the second quarter, other expenses decreased $311 or 10.0% to $2,804 from $3,115 comparing 2015 to 2014. For the six months ended June 30, 2015, other expenses decreased $626 or 10.5% to $5,359 as compared to $5,985 for the same period of 2014. The decrease was the result of realizing cost synergies as we begin to achieve certain of the intended benefits of the 2013 merger with Penseco.

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Income Taxes:

We recorded income tax expense of $1,124 or 20.2% of pre-tax income, and $762 or 18.6% of pre-tax income for the three months ended June 30, 2015 and 2014. We recorded income tax expense of $2,638 or 21.8% of pre-tax income, and $2,225 or 21.7% of pre-tax income for the six months ended June 30, 2015 and 2014.

Peoples Financial Services Corp.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Market risk is the risk to our earnings and/or financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. Our exposure to market risk is primarily interest rate risk (IRR), which arises from our lending, investing and deposit gathering activities. Our market risk sensitive instruments consist of non-derivative financial instruments, none of which are entered into for trading purposes. During the normal course of business, we are not exposed to foreign exchange risk or commodity price risk. Our exposure to IRR can be explained as the potential for change in reported earnings and/or the market value of net worth. Variations in interest rates affect the underlying economic value of assets, liabilities and off-balance sheet items. These changes arise because the present value of future cash flows, and often the cash flows themselves, change with interest rates. The effects of the changes in these present values reflect the change in our underlying economic value, and provide a basis for the expected change in future earnings related to interest rates. Interest rate changes affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. IRR is inherent in the role of banks as financial intermediaries.

A bank with a high degree of IRR may experience lower earnings, impaired liquidity and capital positions, and most likely, a greater risk of insolvency. Therefore, banks must carefully evaluate IRR to promote safety and soundness in their activities.

The projected impacts of instantaneous changes in interest rates on our net interest income and economic value of equity at June 30, 2015, based on our simulation model, as compared to our ALCO policy limits are summarized as follows:

	June 30, 2015			
	% Change in			
Changes in Interest Rates (basis points)	Net Interest Income		Economic Value of Equity	
	Metric	Policy	Metric	Policy
+400	5.9	(20.0)	4.5	(45.0)
+300	4.9	(20.0)	4.7	(35.0)
+200	3.3	(10.0)	3.8	(25.0)
+100	1.7	(10.0)	2.7	(15.0)
Static				
-100	(2.9)	(10.0)	(11.0)	(15.0)

Our simulation model creates pro forma net interest income scenarios under various interest rate shocks. Given instantaneous and parallel shifts in general market rates of plus 100 basis points, our projected net interest income for the 12 months ending June 30, 2015, would increase slightly at 1.7% percent from model results using current interest rates. Additional disclosures about market risk are included in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2014, under the heading Market Risk Sensitivity, and are incorporated into this Item 3 by reference. There were no material changes in our market risk from December 31, 2014.

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Peoples Financial Services Corp.

Item 4. Controls and Procedures.

(a) Evaluation of disclosure controls and procedures.

At June 30, 2015, the end of the period covered by this Quarterly Report on Form 10-Q, the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) evaluated the effectiveness of the Company s disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. Based upon that evaluation, the CEO and CFO concluded that the disclosure controls and procedures, at June 30, 2015, were effective to provide reasonable assurance that information required to be disclosed in the Company s reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and to provide reasonable assurance that information required to be disclosed in such reports is accumulated and communicated to the CEO and CFO to allow timely decisions regarding required disclosure.

(b) Changes in internal control.

There were no changes made in the Company s internal control over financial reporting that occurred during the Company s most recent 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.

The nature of the Company s business generates a certain amount of litigation involving matters arising out of the ordinary course of business. In the opinion of management, there were no legal proceedings that had or might have a material effect on the consolidated results of operations, liquidity, or the financial position of the Company in 2014 and through the date of this quarterly report on Form 10-Q.

Item 1A. Risk Factors.

There have been no material changes from the risk factors previously disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2014.

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Peoples Financial Services Corp.

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

On January 30, 2015, the Board of Directors authorized the repurchase of up to 370,000 shares of the Company s common stock. The following purchases were made by or on behalf of the Company or any affiliated purchaser, as defined in the Exchange Act Rule 10b-18(a) (3), of the Company s common stock during each of the months for the quarter ended June 30, 2015. At June 30, 2015, there were 362,567 shares available for repurchase under the 2015 Stock Repurchase Program with an expiration date of December 31, 2015.

MONTH	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
April 1, 2015 April 30, 2015				368,200
May 1, 2015 May 31, 2015	3,569	$ 38.69	3,569	364,631
June 1 June 30, 2015	2,064	37.57	2,064	362,567
Total	5,633	$ 38.28	5,633	

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

31.1 Chief Executive Officer certification pursuant to Rule 13a-14(a)/15d-14(a).

31.2 Chief Financial Officer certification pursuant to Rule 13a-14(a)/15d-14(a).

32 Chief Executive Officer and Chief Financial Officer certifications pursuant to Section 1350.

101+	Interactive Data File
+	As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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Peoples Financial Services Corp.

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.

	Peoples Financial Services Corp. (Registrant)
Date: August 7, 2015	/s/ Craig W. Best Craig W. Best President and Chief Executive Officer (Principal Executive Officer)
Date: August 7, 2015	/s/ Scott A. Seasock Scott A. Seasock Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

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Peoples Financial Services Corp.

EXHIBIT INDEX

Item Number	Description	Page
31.1	CEO Certification Pursuant to Rule 13a-14 (a) /15d-14 (a).	50
31.2	CFO Certification Pursuant to Rule 13a-14 (a) /15d-14 (a).	51
32	CEO and CFO Certifications Pursuant to Section 1350.	52
101	The following materials from Peoples Financial Services Corp. Quarterly Report on Form 10-Q for the period ended June 30, 2015, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income and Comprehensive Income, (iii) the Consolidated Statements of Changes in Stockholders Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to the Consolidated Financial Statements.	