NORWOOD FINANCIAL CORP
Form 10-Q
August 08, 2012

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

FORM 10-Q

(Mark One)
[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

OR

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

For the transition period from _______________ to ___________________

Commission file number 0-28366

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

Pennsylvania	23-2828306
(State or other jurisdiction of Incorporation or organization)	(I.R.S. employer identification no.)
717 Main Street, Honesdale, Pennsylvania	18431
(Address of principal executive offices)	(Zip Code)

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

NA
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check (x) whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x

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

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

Class	Outstanding as of August 1, 2012
Common stock, par value $0.10 per share	3,277,607

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NORWOOD FINANCIAL CORP.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2012

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
NORWOOD FINANCIAL CORP.
Consolidated Balance Sheets (unaudited)
(dollars in thousands, except share and per share data)

	June 30, 2012	December 31, 2011
ASSETS		
Cash and due from banks	$ 9,135	$ 8,974
Interest bearing deposits with banks	15,261	12,449
Cash and cash equivalents	24,396	21,423
Securities available for sale, at fair value	144,720	150,263
Securities held to maturity, fair value 2012: $177, 2011: $177	172	171
Loans receivable (net of unearned income)	479,421	457,907
Less: Allowance for loan losses	5,775	5,458
Net loans receivable	473,646	452,449
Investment in Federal Home Loan Bank Stock, at cost	3,243	3,593
Bank premises and equipment, net	7,371	7,479
Bank owned life insurance	12,119	11,887
Accrued interest receivable	2,416	2,468
Foreclosed real estate owned	1,268	2,910
Goodwill	9,715	9,715
Other intangibles	720	800
Other assets	5,081	5,656
TOTAL ASSETS	$ 684,867	$ 668,814
LIABILITIES		
Deposits:		
Non-interest bearing demand	$ 82,525	$ 71,959
Interest-bearing	451,632	453,808
Total deposits	534,157	525,767
Short-term borrowings	27,192	21,794
Other borrowings	27,579	27,670
Accrued interest payable	1,335	1,321
Other liabilities	4,363	4,201
TOTAL LIABILITIES	594,626	580,753
STOCKHOLDERS' EQUITY		
Common stock, $.10 par value per share, authorized 10,000,000; shares issued 2012: 3,371,849 shares, 2011: 3,371,866 shares	337	337
Surplus	24,696	24,660
Retained earnings	64,788	62,308
Treasury stock at cost: 2012: 94,242 shares, 2011: 87,370 shares	(2,739)	(2,559)
Accumulated other comprehensive income	3,159	3,315
TOTAL STOCKHOLDERS' EQUITY	90,241	88,061

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	684,867	$	668,814

See accompanying notes to the unaudited consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
INTEREST INCOME				
Loans receivable, including fees	$6,431	$5,468	$12,804	$10,396
Securities	1,007	1,135	2,033	2,225
Other	7	16	11	24
Total interest income	7,445	6,619	14,848	12,645
INTEREST EXPENSE				
Deposits	942	932	1,903	1,817
Short-term borrowings	13	27	24	51
Other borrowings	243	342	487	678
Total interest expense	1,198	1,301	2,414	2,546
NET INTEREST INCOME	6,247	5,318	12,434	10,099
PROVISION FOR LOAN LOSSES	400	430	750	650
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,847	4,888	11,684	9,449
OTHER INCOME				
Service charges and fees	559	592	1,113	1,141
Income from fiduciary activities	80	105	178	218
Net realized gains on sales of securities	285	12	687	224
Gains on sale of loans and servicing rights	66	98	60	241
Other	216	186	459	377
Total other income	1,206	993	2,497	2,201
OTHER EXPENSES				
Salaries and employee benefits	2,047	1,832	4,198	3,533
Occupancy, furniture & equipment	490	408	977	806
Data processing related	216	187	448	402
Taxes, other than income	149	143	301	272
Professional fees	217	126	426	281
Merger related expenses	-	488	18	755
Federal Deposit Insurance Corporation insurance assessment	97	95	196	215
Foreclosed real estate owned expense	85	17	207	36
Other	656	640	1,333	1,170
Total other expenses	3,957	3,936	8,104	7,470
INCOME BEFORE INCOME TAXES	3,096	1,945	6,077	4,180
INCOME TAX EXPENSE	838	461	1,633	1,036
NET INCOME	$2,258	$1,484	$4,444	$3,144
BASIC EARNINGS PER SHARE	$.69	$.50	$1.35	$1.10

DILUTED EARNINGS PER SHARE	$.69	$.50	$1.35	$1.10

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP
Consolidated Statement of Comprehensive Income (unaudited)
(dollars in thousands)

	Three Months Ended June 30, 2012	2011
Net income	$2,258	$1,484
Other Comprehensive income:		
Investment securities available for sale:		
Unrealized holding gains	291	1,161
Tax effect	(100)	(395)
Reclassification of gains recognized in net income	(285)	(12)
Tax effect	97	4
Net of tax amount	3	4
Comprehensive Income	$2,261	$2,242

	Six Months Ended June 30, 2012	2011
Net income	$4,444	$3,144
Other Comprehensive income:		
Investment securities available for sale:		
Unrealized holding gains	445	1,627
Tax effect	(148)	(553)
Reclassification of gains recognized in net income	(687)	(224)
Tax effect	234	76
Net of tax amount	(156)	926
Comprehensive Income	$4,288	$4,070

See accompanying notes to unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Changes in Stockholders' Equity (unaudited)
Six Months Ended June 30, 2012
(dollars in thousands, except share and per share data)

	Common Stock				Treasury Stock		Accumulated Other Comprehensive	
	Shares	Amount	Surplus	Retained Earnings	Shares	Amount	Income	Total
Balance December 31, 2011	3,371,866	$ 337	$ 24,660	$ 62,308	87,370	$ (2,559)	$ 3,315	$ 88,061
Net Income				4,444				4,444
Other comprehensive income							(156)	(156)
Cash dividends declared $.60 per share				(1,964)				(1,964)
Acquisition of treasury stock					11,647	(320)		(320)
Compensation expense related to stock options			66					66
Stock options exercised			(41)		(4,775)	140		99
Tax benefit on stock options			11					11
North Penn exchange adjustment	(17)							
Balance, June 30, 2012	3,371,849	$ 337	$ 24,696	$ 64,788	94,242	$ (2,739)	$ 3,159	$ 90,241

See accompanying notes to the unaudited consolidated financial statements.

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

	Six Months Ended June 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$4,444	$3,144
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	750	650
Depreciation	280	226
Amortization of intangible assets	80	27
Deferred income taxes	(259)	(8)
Net amortization of securities premiums and discounts	580	345
Net realized gain on sales of securities	(687)	(224)
Net increase in value of life insurance	(263)	(180)
Loss on sale of foreclosed real estate	27	-
Net gain on sale of mortgage loans	(74)	(241)
Mortgage loans originated for sale	(2,269)	(6,530)
Proceeds from sale of mortgage loans originated for sale	2,343	6,771
Compensation expense related to stock options	66	82
Decrease (increase) in accrued interest receivable and other assets	985	(182)
(Decrease) increase in accrued interest payable and other liabilities	(1,441)	841
Net cash provided by operating activities	4,562	4,721
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available for sale:		
Proceeds from sales	18,349	10,344
Proceeds from maturities and principal reductions on mortgage-backed securities	17,259	15,918
Purchases	(28,582)	(18,769)
Redemption of FHLB stock	350	328
Net (increase) decrease in loans	(22,883)	8,527
Purchase of bank premises and equipment	(172)	(63)
Proceeds from sale of bank premises and equipment and foreclosed real estate	2,569	-
Acquisition, net of cash acquired	-	4,544
Net cash (used in) provided by investing activities	(13,110)	20,829
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	8,390	8,990
Net increase (decrease) in short-term borrowings	5,398	(1,128)
Repayments of other borrowings	(91)	(3,015)
Stock options exercised	99	-
Tax benefit of stock options exercised	11	-
Acquisition of treasury stock	(320)	(207)
Cash dividends paid	(1,966)	(1,604)
Net cash provided by financing activities	11,521	3,036
Increase (decrease) in cash and cash equivalents	2,973	28,586
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	21,423	16,625

CASH AND CASH EQUIVALENTS, END OF PERIOD	$24,396	$45,211

See accompanying notes to the unaudited consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(dollars in thousands)

	Six Months ENded June 30,	
	2012	2011
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest paid to depositors and borrowers	$2,398	$2,610
Income taxes paid, net of refunds	$1,559	$1,407
Supplemental Schedule of Noncash Investing Activities		
Investment purchases	$1,619	-
Transfers of loans to foreclosed real estate and repossession of other assets	$954	$1,036

See accompanying notes to the unaudited consolidated financial statements.

Notes to the Unaudited Consolidated Financial Statements

1. Basis of Presentation

The unaudited consolidated financial statements include the accounts of Norwood Financial Corp. (Company) and its wholly-owned subsidiary, Wayne Bank (Bank) and the Bank's wholly-owned subsidiaries, WCB Realty Corp., Norwood Investment Corp., Norwood Settlement Services, LLC, and WTRO Properties. All significant intercompany transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in conformity with generally accepted accounting principles for interim financial statements and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. The financial statements reflect, in the opinion of management, all normal, recurring adjustments necessary to present fairly the financial position and results of operations of the Company. The operating results for the six month period ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012 or any other future interim period.

These statements should be read in conjunction with the consolidated financial statements and related notes which are incorporated by reference in the Company's Annual Report on Form 10-K for the year-ended December 31, 2011.

2. Earnings Per Share

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

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

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Basic EPS weighted average shares outstanding	3,276	2,937	3,280	2,852
Dilutive effect of stock options	4	2	3	3
Diluted EPS weighted average shares outstanding	3,280	2,939	3,283	2,855

Stock options which had no intrinsic value, because their effect would be anti-dilutive and therefore would not be included in the diluted EPS calculation were 98,275 and 165,150 as of June 30, 2012 and 2011, respectively, based upon the closing price of Norwood common stock of $28.50 and $26.15 per share on June 30, 2012 and 2011, respectively.

3. Stock-Based Compensation

As of June 30, 2012, there was $65,000 of total unrecognized compensation cost related to non-vested options granted in 2011 under the plan, which will be fully amortized by December 31, 2012.

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

	Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2012	209,914	$ 28.43	6.3 Yrs.	$ 113
Granted	-	-	-	-
Exercised	(4,775)	20.72	.8 Yrs.	31
Forfeited	(12,225)	29.65	5.2 Yrs.	-
Outstanding at June 30, 2012	192,914	28.54	5.9 Yrs.	170
Exercisable at June 30, 2012	164,914	28.72	5.3 Yrs.	142

Intrinsic value represents the amount by which the market price of the stock on the measurement date exceeded the exercise price of the option. The stock price was $28.50 as of June 30, 2012 and $27.47 as of December 31, 2011.

4. Off-Balance Sheet Financial Instruments and Guarantees

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

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

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

(in thousands)	June 30, 2012	June 30, 2011
Unfunded availability under loan commitments	$50,754	$43,395
Unfunded commitments under lines of credit	37,462	28,910
Standby letters of credit	11,248	5,586
	$99,464	$77,891

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

The Bank does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Bank, generally, holds collateral and/or personal guarantees supporting these commitments. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of June 30, 2012 for guarantees under standby letters of credit issued is not material.

5. Securities

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

	June 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Available for Sale:				
U.S. Government agencies	$2,000	$7	$(2)	$2,005
States and political subdivisions	54,163	2,648	(42)	56,769
Corporate obligations	8,635	215	(5)	8,845
Mortgage-backed securities-government sponsored entities	74,944	1,970	(25)	76,889
	139,742	4,840	(74)	144,508
Equity securities-financial services	189	23	-	212
	$139,931	$4,863	$(74)	$144,720
Held to Maturity:				
States and political subdivisions	$172	$5	$-	$177

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available for Sale:				
U.S. Government agencies	$13,268	$130	$-	$13,398
States and political subdivisions	54,106	2,640	-	56,746
Corporate obligations	8,733	130	(54)	8,809
Mortgage-backed securities-government sponsored entities	68,886	2,081	(2)	70,965
	144,993	4,981	(56)	149,918
Equity securities-financial services	239	109	(3)	345
	$145,232	$5,090	$(59)	$150,263
Held to Maturity:				
States and political subdivisions	$171	$6	$-	$177

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

	June 30, 2012					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government Agencies	$998	$(2)	$-	$-	$998	$(2)
States and political subdivisions	3,254	(42)	-	-	3,254	(42)
Corporate obligations	1,457	(5)	-	-	1,457	(5)
Mortgage-backed securities-government sponsored agencies	6,563	(25)	-	-	6,563	(25)
	$12,272	$(74)	$-	$-	$12,272	$(74)

	December 31, 2011					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate obligations	$4,152	$(54)	$-	$-	$4,152	$(54)
Mortgage-backed securities-government sponsored agencies	2,495	(2)	-	-	2,495	(2)
Equity securities-financial services	34	(2)	15	(1)	49	(3)
	$6,681	$(58)	$15	$(1)	$6,696	$(59)

At June 30, 2012, the Company has 14 debt securities in an unrealized loss position in the less than twelve months category and no debt securities in the twelve months or more category. In Management’s opinion the unrealized losses less than twelve months principally reflect changes in interest rates subsequent to the acquisition of specific securities. The Company holds a small amount of equity securities in other financial institutions. As of June 30, 2012, there were no unrealized losses on equity securities. Management believes that the other unrealized loss represents temporary impairment of the security as the Company does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis.

The amortized cost and fair value of debt securities as of June 30, 2012 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)			
Due in one year or less	$10,209	$10,313	$-	$-
Due after one year through five years	7,466	7,690	172	177
Due after five years through ten years	17,363	18,255	-	-
Due after ten years	29,760	31,361	-	-
Mortgage-backed securities-government sponsored agencies	74,944	76,889	-	-
	$139,742	$144,508	$172	$177

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Gross realized gains	$ 285	$ 15	$ 687	$ 228
Gross realized losses	-	(3)	-	(4)
Net realized gain	$ 285	$ 12	$ 687	$ 224
Proceeds from sales of securities	$ 7,716	$ 4,157	$ 18,349	$ 10,344

6. Loans Receivable and Allowance for Loan Losses

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

Types of loans
(dollars in thousands)

	June 30, 2012		December 31, 2011	
Real Estate-Residential	$148,051	30.8 %	$148,148	32.3 %
Commercial	275,258	57.4	262,476	57.3
Construction	15,881	3.3	11,087	2.4
Commercial, financial and agricultural	26,518	5.5	22,684	5.0
Consumer loans to individuals	14,244	3.0	13,934	3.0
Total loans	479,952	100.0 %	458,329	100.0 %
Deferred fees (net)	(531)		(422)	
Allowance for loan losses	(5,775)		(5,458)	
Net loans receivable	$473,646		$452,449	

Changes in the accretable yield for purchased credit-impaired loans were as follows for the six months ended June 30, 2012 (in thousands):

Balance at beginning of period	$171
Accretion	(47)
Reclassification and other	-
Balance at end of period	$124

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

	June 30, 2012 Acquired Loans with Specific Evidence of Deterioration in Credit Quality	December 31, 2011 Acquired Loans with Specific Evidence of Deterioration in Credit Quality
Outstanding Balance	$ 1,346	$ 1,412
Carrying Amount	1,222	1,246

There were no material increases or decreases in the expected cash flows of these loans between May 31, 2011 (the “acquisition date”) and June 30, 2012. There has been no allowance for loan losses recorded for acquired loans with or without specific evidence of deterioration in credit quality as of May 31, 2011 as well as those acquired without specific evidence of deterioration in credit quality as of June 30, 2012. In addition, there has been no allowance for loan losses reversed.

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

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

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

	Real Estate Loans					
June 30, 2012	Residential (In thousands)	Commercial	Construction	Commercial Loans	Consumer Loans	Total
Individually evaluated for impairment	$ -	$ 12,501	$ -	$ 385	$ -	$ 12,886
Loans acquired with deteriorated credit quality	273	951	-	-	-	1,224
Collectively evaluated for impairment	147,778	261,806	15,881	26,133	14,244	465,842
Total loans	$ 148,051	$ 275,258	$ 15,881	$ 26,518	$ 14,244	$ 479,952

	Real Estate Loans					
December 31, 2011	Residential (In thousands)	Commercial	Construction	Commerical Loans	Consumer Loans	Total
Individually evaluated for impairment	$ -	$ 11,786	$ -	$ 598	$ -	$ 12,384
Loans acquired with deteriorated credit quality	343	903	-	-	-	1,246
Collectively evaluated for impairment	147,805	249,787	11,087	22,086	13,934	444,699
Total Loans	$ 148,148	$ 262,476	$ 11,087	$ 22,684	$ 13,934	$ 458,329

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

	Recorded Investment (In thousands)	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
June 30, 2012					
With no related allowance recorded:					
Real Estate Loans					
Residential	$273	$297	$-	$289	$2
Commercial	5,420	5,520	-	5,902	40
Commercial Loans	385	385	-	385	-
Total	6,078	6,202	-	6,576	42
With an allowance recorded:					
Real Estate Loans					
Commercial	8,031	8,031	1,120	7,379	106
Total	8,031	8,031	1,120	7,379	106
Total:					
Real Estate loans					
Residential	273	297	-	289	2
Commercial	13,451	13,551	1,120	13,281	146
Commercial Loans	385	385	-	385	-
Total Impaired Loans	$14,109	$14,233	$1,120	$13,955	$148

	Recorded Investment (In thousands)	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2011					
With no related allowance recorded:					
Real Estate Loans					
Residential	$343	$385	$-	$245	$7
Commercial	5,866	5,995	-	5,372	340
Commercial Loans	598	598	-	496	10
Total	6,807	6,978	-	6,113	357
With an allowance recorded:					
Real Estate Loans					
Commercial	6,823	6,823	1,231	9,670	204
Total	6,823	6,823	1,231	9,670	204
Total:					
Real Estate loans					
Residential	343	385	-	245	7
Commercial	12,689	12,818	1,231	15,042	544
Commercial Loans	598	598	-	496	10
Total Impaired Loans	$13,630	$13,801	$1,231	$15,783	$561

Troubled debt restructured loans are those loans whose terms have been renegotiated to provide a reduction or deferral of principal or interest as a result of financial difficulties experienced by the borrower, who could not obtain comparable terms from alternate financing sources. As of June 30, 2012, troubled debt restructured loans totaled $7.1 million and resulted in specific reserves of $991,000. There were no defaults on restructured loans during the past twelve months. During 2012 and 2011, there were no new loans identified as troubled debt restructurings. As of December 31, 2011, troubled debt restructured loans totaled $7.2 million and resulted in specific reserves of $1.2 million.

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

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

and over to assign or re-affirm risk ratings. Loans in the Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard, Doubtful and Loss within the internal risk rating system as of June 30, 2012 and December 31, 2011 (in thousands):

June 30, 2012	Pass	Special Mention	Substandard	Doubtful	Total
Commercial real estate loans	$250,726	$9,825	$14,707	$-	$275,258
Commercial loans	25,842	238	438	-	26,518
Total	$276,568	$10,063	$15,145	$-	$301,776

December 31, 2011	Pass	Special Mention	Substandard	Doubtful	Total
Commercial real estate loans	$237,407	$11,009	$14,060	$-	$262,476
Commercial loans	21,598	427	659	-	22,648
Total	$259,005	$11,436	$14,719	$-	$285,160

For residential real estate loans, construction loans and consumer loans, the Company evaluates credit quality based on the performance of the individual credits. Nonperforming loans include loans on nonaccrual status and accruing loans which are past due over ninety days. The following table presents the recorded investment in the loan classes based on payment activity as of June 30, 2012 and December 31, 2011 (in thousands):

June 30, 2012	Performing	Nonperforming	Total
Residential real estate loans	$ 145,530	$ 2,521	$ 148,051
Construction	15,881	-	15,881
Consumer loans	14,244	-	14,244
Total	$ 175,655	$ 2,521	$ 178,176

December 31, 2011	Performing	Nonperforming	Total
Residential real estate loans	$ 145,061	$ 3,087	$ 148,148
Construction	11,087	-	11,087
Consumer loans	13,934	-	13,934
Total	$ 170,082	$ 3,087	$ 173,169

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Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of June 30, 2012 and December 31, 2011 (in thousands):

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
June 30, 2012							
Real Estate loans							
Residential	$ 145,026	$ 435	$ 69	$ -	$ 2,521	$ 3,025	$ 148,051
Commercial	268,298	986	-	2	5,972	6,960	275,258
Construction	15,816	65	-	-	-	65	15,881
Commercial loans	26,131	2	-	-	385	387	26,518
Consumer loans	14,144	87	12	1	-	100	14,244
Total	$ 469,415	$ 1,575	$ 81	$ 3	$ 8,878	$ 10,537	$ 479,952

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
December 31, 2011							
Real Estate loans							
Residential	$ 143,550	$ 160	$ 1,351	$ -	$ 3,087	$ 4,598	$ 148,148
Commercial	255,613	1,015	1,524	-	4,324	6,863	262,476
Construction	10,532	-	555	-	-	555	11,087
Commercial loans	22,086	194	-	-	404	598	22,684
Consumer loans	13,835	89	10	-	-	99	13,934
Total	$ 445,616	$ 1,458	$ 3,440	$ -	$ 7,815	$ 12,713	$ 458,329

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

(In thousands)	Residential Real Estate	Commercial Real Estate	Construction	Commercial	Consumer	Total
Beginning balance, December 31, 2011	$ 1,257	$ 3,838	$ 72	$ 147	$ 144	$ 5,458
Charge Offs	(308)	(96)	(7)	-	(33)	(444)
Recoveries	1	-	-	-	10	11
Provision Expense	609	(51)	22	116	54	750
Ending balance, June 30, 2012	$ 1,559	$ 3,691	$ 87	$ 263	$ 175	$ 5,775
Ending balance individually evaluated for impairment	$ -	$ 1,120	-	-	-	$ 1,120
Ending balance collectively evaluated for impairment	$ 1,559	$ 2,571	$ 87	$ 263	$ 175	$ 4,655

(In thousands)	Residential Real Estate	Commercial Real Estate	Construction	Commercial	Consumer	Total
Beginning balance, December 31, 2010	$ 1,167	$ 3,976	$ 110	$ 171	$ 192	$ 5,616
Charge Offs	(226)	(764)	-	(2)	(41)	(1,033)
Recoveries	7	-	-	5	22	34
Provision Expense	148	463	(19)	84	(26)	650
Ending balance, June 30, 2011	$ 1,096	$ 3,675	$ 91	$ 258	$ 147	$ 5,267
Ending balance individually evaluated for impairment	$ -	$ 1,678	-	-	-	$ 1,678
Ending balance collectively evaluated for impairment	$ 1,096	$ 1,997	$ 91	$ 258	$ 147	$ 3,589

The Company’s primary business activity is with customers located in northeastern Pennsylvania. Accordingly, the Company has extended credit primarily to commercial entities and individuals in this area whose ability to honor their contracts is influenced by the region’s economy.

As of June 30, 2012, the Company considered its concentration of credit risk to be acceptable. The highest concentrations are in the hospitality lodging industry and builders/contractors with loans outstanding of $44.1 million, or 49.6% of capital, to the hospitality lodging industry and $14.1 million, or 19.7% of capital, to builders/contractors. There were no losses recognized on loans to the hospitality industry or to builders/contractors during the current period.

Gross realized gains and gross realized losses on sales of residential mortgage loans were $74,000 and $0 respectively, in the first six months of 2012 compared to $94,000 and $0, respectively, in the same period in 2011. The proceeds from the sales of residential mortgage loans totaled $2.3 million and $6.7 million for the six months ended June 30, 2012 and 2011, respectively.

7. Fair Value Measurements

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

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

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

Securities:

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

We may be required from time to time to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or market accounting or write-downs of individual assets.

Impaired loans (carried at fair value):

The Company measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Foreclosed real estate owned (carried at fair value):

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

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2012 and December 31, 2011 are as follows:

		Fair Value Measurement Using		
Description	Total	(Level 1)	(Level 2)	(Level 3)
(In thousands)				
June 30, 2012				
Available for Sale:				
U.S. Government agencies	$2,005	$-	$2,005	$-
States and political subdivisions	56,769	-	56,769	-
Corporate obligations	8,845	-	8,845	-
Mortgage-backed securities-government sponsored agencies	76,889	-	76,889	-
Equity securities-financial services	212	212	-	-
Total	$144,720	$212	$144,508	$-
December 31, 2011				
Available for Sale:				
U.S. Government agencies	$13,398	$-	$13,398	$-
States and political subdivisions	56,746	-	56,746	-
Corporate obligations	8,809	-	8,809	-
Mortgage-backed securities-government sponsored agencies	70,965	-	70,965	-
Equity securities-financial services	345	345	-	-
Total	$150,263	$345	$149,918	$-

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2012 and December 31, 2011 are as follows:

		Fair Value Measurement using		
(In thousands)				
Description	Total	(Level 1)	(Level 2)	(Level 3)
June 30, 2012				
Impaired Loans	$12,990	$-	$-	$12,990
Foreclosed Real Estate Owned	1,268	-	-	1,268
	$14,258	$-	$-	$14,258
December 31, 2011				
Impaired Loans	$12,399	$-	$-	$12,399
Foreclosed Real Estate Owned	2,910	-	-	2,910
	$15,309	$-	$-	$15,309

There were no assets measured at fair value on a recurring basis for which the Company has utilized Level 3 inputs to determine fair value at June 30, 2012.

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

	Quantitative Information about Level 3 Fair Value Measurements			
(In thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range(Weighted Average)
June 30, 2012				
Impaired loans	$12,990	Appraisal of collateral(1)	Appraisal adjustments(2)	0-20%
Foreclosed real estate owned	$1,268	Appraisal of collateral(1)(3)	Liquidation expenses(2)	20%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable, less any associated allowance.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.
(3) Includes qualitative adjustments by management and estimated liquidation expenses.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company’s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company’s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company’s financial instruments at June 30, 2012 and December 31, 2011.

Cash and cash equivalents (carried at cost):

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

Loans receivable (carried at cost):

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

Mortgage servicing rights (generally carried at cost)

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

Investment in Federal Home Loan Bank stock (carried at cost):

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

Bank owned life insurance (carried at cost):

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

Accrued interest receivable and payable (carried at cost):

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

Deposit liabilities (carried at cost):

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

Short-term borrowings (carried at cost):

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

Other borrowings (carried at cost):

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

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

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

The estimated fair values of the Bank's financial instruments were as follows at June 30, 2012 and December 31, 2011. (In thousands)

	Fair Value Measurements at June 30, 2012				
	Carrying Amount	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 due from banks, interest-bearing deposits with banks and federal funds sold	$24,396	$24,396	$24,396	$-	$ -
Securities	144,892	144,897	212	144,685	-
Loans receivable, net	473,646	483,418	-	-	483,418
Mortgage servicing rights	288	286	286	-	-
Investment in FHLB stock	3,243	3,243	3,243	-	-
Bank owned life insurance	12,119	12,119	12,119	-	-
Accrued interest receivable	2,416	2,416	2,416	-	-
Financial liabilities:					
Deposits	534,157	535,878	319,552	-	216,326
Short-term borrowings	27,192	27,192	27,192	-	-
Other borrowings	27,579	30,947	-	-	30,947
Accrued interest payable	1,335	1,335	1,335	-	-
Off-balance sheet financial instruments					
Commitments to extend credit and outstanding letters of credit	-	-	-	-	-

	Fair Value Measurements at December 31, 2011	
	Carrying Amount	Fair Value
Financial assets:		
Cash and due from banks, interest-bearing deposits with banks and federal funds sold	$ 21,423	$ 21,423
Securities	150,434	150,440
Loans receivable, net	452,449	463,118
Mortgage servicing rights	302	308
Investment in FHLB stock	3,593	3,593
Bank owned life insurance	11,887	11,887
Accrued interest receivable	2,468	2,468
Financial liabilities:		
Deposits	525,767	527,707
Short-term borrowings	21,794	21,794
Other borrowings	27,670	30,002
Accrued interest payable	1,321	1,321
Off-balance sheet financial instruments:		
Commitments to extend credit and outstanding letters of credit	-	-

8. New and Recently Adopted Accounting Pronouncements

Recent Accounting Pronouncements:

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Company has provided the necessary disclosure in Note 7.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The amendments in this Update improve the comparability, clarity, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS, the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive

income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. All entities that report items of comprehensive income, in any period presented, will be affected by the changes in this Update. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The amendments in this Update should be applied retrospectively, and early adoption is permitted. The Company has provided the necessary disclosure in the Consolidated Statement of Comprehensive Income.

In September 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other Topics (Topic 350), Testing Goodwill for Impairment. The objective of this update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this Update apply to all entities, both public and nonpublic, that have goodwill reported in their financial statements and are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The Company has provided the necessary disclosure in Item 2 of this Form 10-Q.

In September 2011, the FASB issued ASU 2011-09, Compensation-Retirement Benefits-Multiemployer Plans (Subtopic 715-80):Disclosures about an Employer's Participation in a Multiemployer Plan. The amendments in this Update will require additional disclosures about an employer's participation in a multiemployer pension plan to enable users of financial statements to assess the potential cash flow implications relating to an employer's participation in multiemployer pension plans. The disclosures also will indicate the financial health of all of the significant plans in which the employer participates and assist a financial statement user to access additional information that is available outside the financial statements. For public entities, the amendments in this Update are effective for annual periods for fiscal years ending after December 15, 2011, with early adoption permitted. The amendments should be applied retrospectively for all prior periods presented. The Company has adopted this standard.

In December 2011, the FASB issued ASU 2011-10, Property, Plant, and Equipment (Topic 360): Derecognition of in Substance Real Estate-a Scope Clarification. The amendments in this Update affect entities that cease to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt. Under the amendments in this Update, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, a reporting entity would not satisfy the requirements to derecognize the in substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related nonrecourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest under Subtopic 810-10, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary's operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The amendments in this Update should be applied on a prospective basis to deconsolidation events occurring after the effective date. Prior periods should not be adjusted even if the reporting entity has continuing involvement with previously derecognized in substance real estate entities. For public entities, the amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. Early adoption is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In December 2011, the FASB issued ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. The amendments in this Update affect all entities that have financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement. The requirements amend the disclosure requirements on offsetting in Section 210-20-50. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this Update. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. This ASU is not expected to have a significant impact on the Company’s financial statements.

In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. In order to defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this Update supersede certain pending paragraphs in Update 2011-05. Entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05. All other requirements in Update 2011-05 are not affected by this Update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company has provided the necessary disclosure in the Consolidated Statement of Comprehensive Income.

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

Forward-Looking Statements

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

- our ability to realize the anticipated benefits from our acquisition of North Penn Bancorp, Inc.
- our ability to effectively manage future growth
- loan losses in excess of our allowance
- risks inherent in commercial lending
- real estate collateral which is subject to declines in value
- potential other-than-temporary impairments
- higher deposit insurance premiums
- soundness of other financial institutions
- increased compliance burden under new financial reform legislation
- risk of failure to stabilize the financial system
- current market volatility
- potential liquidity risk
- availability of capital

- regional economic factors
- loss of senior officers
- comparatively low legal lending limits
- limited market for the Company’s stock
- restrictions on ability to pay dividends
- common stock may lose value
- competitive environment
- issuing additional shares may dilute ownership
- extensive and complex governmental regulation and associated cost
- interest rate risks

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

Critical Accounting Policies

Note 2 to the Company’s consolidated financial statements for the year ended December 31, 2011 (incorporated by reference in Item 8 of the Form 10-K) lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of the Company and its results of operations.

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

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

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

Bonds, notes and debentures for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the term of the security.

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

Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to not sell the securities and it is more likely than not that it will not have to sell the securities before recovery of their cost basis.

The Company, as a member of the Federal Home Loan Bank (FHLB) system is required to maintain an investment in capital stock of its district FHLB according to a predetermined formula. This restricted stock has not quoted market value and is carried at cost.

The FHLB incurred losses in both 2009 and 2010 and had suspended the payment of dividends. However, the FHLB has shown positive results during 2011 and 2012 which includes stock redemptions and resumed dividend payments. The losses were primarily attributable to impairment of investment securities associated with the extreme economic conditions in place during the previous several years. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. More consideration was given to the long-term prospects for the FHLB as opposed to the recent stress caused by the extreme economic conditions the world is facing. Management also considered that the FHLB's regulatory capital ratios have increased from the prior year, liquidity appears adequate, and the new shares of FHLB stock continue to change hands at the $100 par value.

Management evaluates the restricted stock for impairment. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary decline in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB. Management believes no impairment charge is necessary related to the restricted stock as of June 30, 2012 and December 31, 2011.

In estimating other-than-temporary impairment losses on securities, the Company considers 1) the length of time and extent to which the fair value has been less than cost, 2) the financial condition of the issuer, and 3) the intent and ability of the Company to hold the security to allow for a recovery to fair value. The Company believes that the unrealized loss on all other securities at June 30, 2012 and December 31, 2011 represents temporary impairment of the securities, related to changes in interest rates.

In connection with the acquisition of North Penn, we recorded goodwill in the amount of $9.7 million, representing the excess of amounts paid over the fair value of net assets of the institutions acquired in purchase transactions, at its fair value at the date of acquisition. Goodwill is tested and deemed impaired when the carrying value of goodwill exceeds its implied fair value. The Company performed an assessment of key factors as of May 31, 2012 and determined that impairment of goodwill was not likely. The value of the goodwill can change in the future. We expect the value of the goodwill to decrease if there is a significant decrease in the franchise value of the Bank. If an impairment loss is determined in the future, we will reflect the loss as an expense for the period in which the impairment is determined, leading to a reduction of our net income for that period by the amount of the impairment loss.

Changes in Financial Condition

General
Total assets as of June 30, 2012 were $684.9 million compared to $668.8 million as of December 31, 2011, an increase of $16.1 million. The increase includes $21.5 million of loan growth which was funded with an $8.4 million increase in deposits and proceeds from sales or maturities of securities.

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Securities

The fair value of securities available for sale as of June 30, 2012 was $144.7 million compared to $150.3 million as of December 31, 2011. The Company purchased $28.6 million of securities principally using the proceeds from $35.6 million of securities sold, called, maturities and principal reductions.

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

	June 30, 2012		December 31, 2011	
(dollars in thousands)	Amount	% of portfolio	Amount	% of portfolio
U.S. Government agencies	$2,005	1.4 %	$13,398	8.9 %
States and political subdivisions	56,941	39.3	56,917	37.8
Corporate obligations	8,845	6.1	8,809	5.9
Mortgage-backed securities- government sponsored entities	76,889	53.1	70,965	47.2
Equity securities-financial services	212	0.1	345	0.2
Total	$144,892	100.0 %	$150,434	100.0 %

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

Loans

Loans receivable totaled $479.4 million at June 30, 2012 compared to $457.9 million as of December 31, 2011. The majority of the growth recorded in 2012 was centered in commercial loans. Commercial real estate loans increased $12.8 million during the period while other commercial loans increased $3.8 million.

The allowance for loan losses totaled $5,775,000 as of June 30, 2012 and represented 1.20% of total loans, compared to $5,458,000 at December 31, 2011, and $5,267,000 as of June 30, 2011. The Company had net charge-offs for the six months ended June 30, 2012 of $433,000 compared to $999,000 in the comparable period in 2011. The Company's loan review process assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes an analysis of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and a historical review of credit losses by loan type. Other factors considered include: concentration of credit in specific industries; economic and industry conditions; trends in delinquencies and loan classifications, large dollar exposures and loan growth. Management considers the allowance adequate at June 30, 2012 based on the Company's criteria. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any, that might be incurred in the future.

As of June 30, 2012, non-performing loans totaled $8.9 million, which is 1.85% of total loans compared to $7,815,000, or 1.71% of total loans at December 31, 2011.

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

(dollars in thousands)	June 30, 2012			December 31, 2011		
Loans accounted for on a non-accrual basis:						
Commercial and all other	$	385		$	404	
Real Estate		8,493			7,411	
Total		8,878			7,815	
Accruing loans which are contractually past due 90 days or more		3			-	
Total non-performing loans		8,881			7,815	
Foreclosed real estate		1,268			2,910	
Total non-performing assets	$	10,149		$	10,725	
Allowance for loans losses		5,775			5,458	
Coverage of non-performing loans	$	.65x		$	.70x	
Non-performing loans to total loans		1.85	%		1.71	%
Non-performing loans to total assets		1.30	%		1.17	%
Non-performing assets to total assets		1.48	%		1.60	%

Deposits

During the period, total deposits increased $8.4 million which includes growth of $10.6 million in non-interest bearing demand deposits, a $2.8 million increase in money market and NOW accounts, and a $2.2 million increase in savings deposits. Certificates of deposit decreased $7.2 million due primarily to the seasonality of municipal deposits.

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

(dollars in thousands)	June 30, 2012		December 31, 2011	
Non-interest bearing demand	$	82,525	$	71,959
Interest bearing demand		50,001		51,161
Money market deposit accounts		118,003		114,007
Savings		69,023		66,866
Time deposits <$100,000		144,862		141,220
Time deposits >$100,000		69,743		80,554
Total	$	534,157	$	525,767

Borrowings

Short-term borrowings as of June 30, 2012 totaled $27.2 million compared to $21.8 million as of December 31, 2011. Securities sold under agreements to repurchase increased $5.4 million principally due to the seasonality of municipal cash management accounts. Short-term borrowings consist of securities sold under agreements to repurchase, which totaled $27.2 million on June 30, 2012 and $21.8 million on December 31, 2011.

Other borrowings consisted of the following:

(dollars in thousands)

	June 30, 2012	December 31, 2011
Notes with the FHLB:		
Convertible note due October 2012 at 4.37%	$ 5,000	$ 5,000
Convertible note due May 2013 at 3.015%	5,000	5,000
Fixed rate note due July 2015 at 4.34%	7,579	7,670
Convertible note due January 2017 at 4.71%	10,000	10,000
	$ 27,579	$ 27,670

The convertible notes contain an option which allows the FHLB, at quarterly intervals to change the note to an adjustable-rate advance at three month LIBOR plus 11 to 19 basis points. If the notes are converted, the option allows the Bank to put the funds back to the FHLB at no charge. The fixed rate borrowing due July 2015 includes a $579,000 fair value adjustment recorded at the time of the North Penn acquisition.

Off-Balance Sheet Arrangements

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Commitments to grant loans totaled $42.5 million as of June 30, 2012 compared to $43.1 million as of December 31, 2011.

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

	June 30, 2012	December 31, 2011
	(in thousands)	
Unfunded availability under loan commitments	$ 50,754	$ 43,081
Unfunded commitments under lines of credit	37,462	29,255
Standby letters of credit	11,248	11,892
	$ 99,464	$ 84,228

Stockholders' Equity and Capital Ratios

As of June 30, 2012, stockholders' equity totaled $90.2 million, compared to $88.1 million as of December 31, 2011. The net change in stockholders' equity included $4.4 million of net income, that was partially offset by $2.0 million of dividends declared. In addition, accumulated other comprehensive income decreased $156,000 due to a decrease in fair value of securities in the available for sale portfolio, net of tax. This decrease in fair value is the result of a change in interest rates and spreads, which may impact the value of the securities. Because of interest rate volatility, the Company's accumulated other comprehensive income could materially fluctuate for each interim and year-end period.

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

	June 30, 2012	December 31, 2011
Tier 1 Capital		
(To average assets)	11.50%	11.29%
Tier 1 Capital		
(To risk-weighted assets)	15.75%	15.86%
Total Capital		
(To risk-weighted assets)	16.93%	17.04%

The minimum capital requirements imposed by the FDIC on the Bank for leverage, Tier 1 and Total Capital are 4%, 4% and 8%, respectively. The Company has similar capital requirements imposed by the Board of Governors of the Federal Reserve System (FRB). The Bank is also subject to more stringent Pennsylvania Department of Banking (PDB) guidelines. The Bank's capital ratios do not differ significantly from the Company's ratios. Although not adopted in regulation form, the PDB utilizes capital standards requiring a minimum of 6.5% leverage capital and 10% total capital. The Company and the Bank were in compliance with applicable FRB, FDIC and PDB capital requirements as of June 30, 2012 and December 31, 2011.

Liquidity

As of June 30, 2012, the Company had cash and cash equivalents of $24.4 million in the form of cash, due from banks and short-term deposits with other institutions. In addition, the Company had total securities available for sale of $144.7 million which could be used for liquidity needs. This totals $169.1 million and represents 24.7% of total assets compared to $171.7 million and 25.7% of total assets as of December 31, 2011. The Company also monitors other liquidity measures, all of which were within the Company's policy guidelines as of June 30, 2013 and December 31, 2011. Based upon these measures, the Company believes its liquidity is adequate.

Capital Resources

The Company has a line of credit commitment available from the Federal Home Loan Bank (FHLB) of Pittsburgh for borrowings of up to $20,000,000 which expires in December 2016. There were no borrowings under this line at June 30, 2013 and December 31, 2011.

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

The Company has a line of credit commitment available which has no stated expiration date from PNC Bank for $16,000,000. Borrowings under this line were $-0- as of June 30, 2012 and December 31, 2011.

The Bank's maximum borrowing capacity with the Federal Home Loan Bank was approximately $260,000,000 as of June 30, 2012, of which $27,000,000 was outstanding at June 30, 2012 and December 31, 2011 respectively. Advances from the Federal Home Loan Bank are secured by qualifying assets of the Bank.

Non-GAAP Financial Measures

This report contains or references fully taxable-equivalent (fte) interest income and net interest income, which are non-GAAP financial measures. Interest income (fte) and net interest income (fte) are derived from GAAP interest income and net interest income using an assumed tax rate of 34%. We believe the presentation

of interest income (fte) and net interest income (fte) ensures comparability of interest income and net interest income arising from both taxable and tax-exempt sources and is consistent with industry practice. Net interest income (fte) is reconciled to GAAP net interest income on page 37 and 41. Although the Company believes that these non-GAAP financial measures enhance investors' understanding of our business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP measures.

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

(Tax-Equivalent Basis, dollars in thousands)	Three Months Ended June 30, 2012 Average Balance (2)	Interest (1)	Average Rate (3)	2011 Average Balance (2)	Interest (1)	Average Rate (3)
Assets						
Interest-earning assets:						
Federal funds sold	$ -	$ -	0.00 %	$ 615	$ -	0.00 %
Interest bearing deposits with banks	11,261	7	0.25	25,136	16	0.25
Securities held-to-maturity	172	3	6.98	170	4	9.41
Securities available for sale:						
Taxable	89,790	527	2.35	101,963	695	2.73
Tax-exempt (1)	52,197	722	5.53	46,847	662	5.65
Total securities available for sale (1)	141,987	1,249	3.52	148,810	1,357	3.65
Loans receivable (1) (4) (5)	481,524	6,504	5.40	387,203	5,517	5.70
Total interest earning assets	634,944	7,763	4.89	561,934	6,894	4.91
Non-interest earning assets:						
Cash and due from banks	9,077			7,443		
Allowance for loan losses	(5,776)			(5,753)		
Other assets	43,844			33,047		
Total non-interest earning assets	47,145			34,737		
Total Assets	$ 682,089			$ 596,671		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest bearing demand and money market	$ 169,343	135	0.32	$ 126,053	132	0.42
Savings	68,947	25	0.15	68,622	53	0.31
Time	223,147	782	1.40	185,475	747	1.61
Total interest bearing deposits	461,437	942	0.82	380,150	932	0.98
Short-term borrowings	19,346	13	0.27	30,634	27	0.35
Other borrowings	27,605	243	3.52	37,563	342	3.64
Total interest bearing liabilities	508,388	1,198	0.94	448,347	1,301	1.16
Non-interest bearing liabilities:						
Demand deposits	79,378			67,922		
Other liabilities	4,069			4,881		
Total non-interest bearing liabilities	83,447			72,803		
Stockholders' equity	90,254			75,521		

Total Liabilities and Stockholders' Equity	$ 682,089			$ 596,671		
Net interest income (tax equivalent basis)		6,565	3.95 %		5,593	3.75 %
Tax-equivalent basis adjustment		(318)			(275)	
Net interest income		$ 6,247			$ 5,318	
Net interest margin (tax equivalent basis)			4.14 %			3.98 %

(1) Interest and yields are presented on a tax-equivalent basis using a marginal tax rate of 34%.
(2) Average balances have been calculated based on daily balances.
(3) Annualized
(4) Loan balances include non-accrual loans and are net of unearned income.
(5) Loan yields include the effect of amortization of deferred fees, net of costs.

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

Increase/(Decrease)