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NORWOOD FINANCIAL CORP
Form 10-K405
March 25, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One):

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2001,

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from _____ to _____.

Commission File No. 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)

Issuer's Telephone Number, Including Area Code: (570) 253-1455

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

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

Common Stock, par value \$.10 per share

(Title of Class)

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

YES NO .

Indicate by check mark 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.

As of March 16, 2002, there were 1,753,733 shares outstanding of the registrant's Common Stock.

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The Registrant's voting stock trades on the NASDAQ National Market under the symbol "NWFL." The aggregate market value of the voting stock held by non-affiliates of the registrant, based on the last price the registrant's Common Stock was sold on March 16, 2002, was \$36,968,385 (\$26.15 per share based on 1,413,702 shares of Common Stock outstanding).

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders for the Fiscal Year ended December 31, 2001. (Parts I, II, and IV)
2. Portions of the Proxy Statement for the Annual Meeting of Stockholders. (Part III)

PART I

Forward Looking Statements

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words "believes", "anticipates," "contemplates," "expects," and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, risks associated with the effect of opening a new branch, the ability to control costs and expenses, and general economic conditions. 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.

Item 1. Business.

General

Norwood Financial Corp. (the "Company") a Pennsylvania corporation is the holding company for Wayne Bank. On March 29, 1996, the Bank completed the Reorganization and became a wholly owned subsidiary of the Company. At December 31, 2001, the Company had total assets of \$346.0 million, deposits of \$274.9 million, and stockholders' equity of \$35.1 million.

Wayne Bank is a Pennsylvania chartered commercial bank located in Honesdale, Pennsylvania. The Bank was originally chartered on February 17, 1870 as Wayne County Savings Bank. Wayne County Savings Bank changed its name to Wayne County Bank and Trust in December 1943. In September 1993, the Bank adopted the name Wayne Bank. The Bank's deposits are currently insured by the Bank Insurance Fund ("BIF") as administered by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is regulated by the Pennsylvania Department of Banking ("PDB") and the FDIC.

The Bank is an independent community-oriented bank with six offices in Wayne County, three offices in Pike County and one office in Monroe County. The Bank offers a wide variety of personal, business credit services and trust and investment products to the consumers, businesses, nonprofit organizations, and municipalities in each of the communities that the Bank serves. The Bank primarily serves the Pennsylvania counties of Wayne, Pike and Monroe, and to a much lesser extent, the counties of Lackawanna and Susquehanna. In addition, the Bank operates eleven automated teller machines with ten in branch locations and one remote service facility.

Competition

The competition for deposit products comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional banks in the Company's market area of Wayne, Pike and Monroe Counties, Pennsylvania. Deposit competition also includes a number of insurance products sold by local agents and investment products such as mutual funds and other securities sold by local and regional brokers. Loan competition varies depending upon market conditions and comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, multi-state regional banks, and mortgage bankers.

Personnel

As of December 31, 2001, the Bank had 119 full-time and 12 part-time employees. None of the Bank's employees are represented by a collective bargaining group.

Lending Activities

The Bank's loan products include loans for personal and business use. This includes mortgage lending to finance principal residences as well as "seasonal" or second home dwellings. The products include adjustable rate mortgages up to 30 years which are retained and serviced through the Bank, longer term fixed rate mortgage products which may be sold, servicing retained, in the secondary market through the Federal National Mortgage Association (Fannie Mae) or held in the Bank's portfolio subject to certain internal guidelines. Fixed rate home equity loans are originated on terms up to 180 months, as well as offering a home equity line of credit tied to prime rate. The Bank also offers indirect dealer financing of automobiles (new and used), boats, and recreational vehicles through a network of over 60 dealers in Northeast Pennsylvania.

Commercial loans and commercial mortgages are provided to local small and mid-sized businesses at a variety of terms and rate structures. Commercial lending activities include lines of credit, revolving credit, term loans, mortgages, various forms of secured lending and a limited amount of letter of credit facilities. The structure may be fixed, immediately repricing tied to the prime rate or adjustable at set intervals.

Adjustable-rate loans decrease the risks associated with changes in interest rates by periodically repricing, but involve other risks because as interest rates increase, the underlying payments by the borrower increase, thus increasing the potential for default. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate may also be limited by the maximum periodic interest rate adjustment permitted in certain adjustable-rate mortgage loan documents, and, therefore is potentially limited in effectiveness during periods of rapidly rising interest rates. These risks have not had an adverse effect on the Bank.

Consumer lending, including indirect financing provides benefits to the Bank's asset/liability management program by reducing the Bank's exposure to interest rate changes, due to their generally shorter terms, and higher yields. Such loans may entail additional credit risks compared to owner-occupied

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residential mortgage lending. However, the Bank believes that the higher yields and shorter terms compensate the Bank for the increased credit risk associated with such loans.

Commercial lending including real-estate related loans entail significant additional risks when compared with residential real estate and consumer lending. For example, commercial loans typically involve larger loan balances to single borrowers or groups of related borrowers, the payment experience on such loans typically is dependent on the successful operation of the project and these risks can be significantly impacted by the cash flow of the borrowers and market conditions for commercial office, retail, and warehouse space. In periods of decreasing cash flows, the commercial borrower may permit a lapse in general maintenance of the property causing the value of the underlying collateral to deteriorate. The liquidation of commercial property is often more costly and may involve more time to sell than residential real estate.

Due to the type and nature of the collateral, consumer lending generally involves more credit risk when compared with residential real estate lending. Consumer lending collections are typically dependent on the borrower's continuing financial stability, and thus, are more likely to be adversely affected by job loss, divorce, illness and personal bankruptcy. In most cases, any repossessed collateral for a defaulted consumer loan will not provide an adequate source of repayment of the outstanding loan balance. The remaining deficiency is usually turned over to a collection agency.

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Types of Loans. Set forth below is selected data relating to the composition of the Bank's loan portfolio at the dates - indicated.

	As of December 31,					
	2001		2000		1999	
	\$	%	\$	%	\$	%
	(Dollars in Thousands)					
Type of Loans:	-----					
Commercial, Financial and						
Agricultural.....	\$17,442	8.1	\$17,102	7.9	\$15,672	7.6
Real Estate-Construction.....	4,642	2.2	2,425	1.1	3,339	1.6
Residential.....	64,635	30.1	59,517	27.5	56,967	27.7
Commercial.....	63,609	29.6	56,815	26.2	51,562	25.1
Lease financing, net of unearned						
income.....	6,126	2.9	13,644	6.3	23,974	11.7
Consumer Loans to Individuals.....	58,143	27.1	67,286	31.0	54,045	26.3
	214,597	100.0	216,789	100.0	205,559	100.0
	=====	=====	=====	=====	=====	=====
Less:						
Unearned income and deferred fees....	(403)		(312)		(399)	
Allowance for loan losses.....	(3,216)		(3,300)		(3,344)	
	\$210,978		\$213,177		\$201,816	
	=====		=====		=====	

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Maturities and Sensitivities of Loans to Changes in Interest Rates. The following table sets forth maturities and interest rate sensitivity for selected categories of loans as of December 31, 2001. Scheduled repayments are reported in the maturity category in which payment is due.

	Less than One Year -----	One to Five Years -----	Over Five Years -----	Total -----
	(Dollars in thousands)			
Commercial, Financial and Agricultural	\$ 5,932	\$ 6,446	\$ 5,064	\$17,442
Real Estate- Construction	4,642	--	--	4,642
Commercial	4,185	11,225	48,199	63,609
	-----	-----	-----	-----
Total	\$14,759	\$17,671	\$53,263	\$85,693
	=====	=====	=====	=====
Loans with fixed-rate	\$ 2,346	\$ 6,952	\$10,929	\$20,227
Loans with floating Rates	12,413	10,719	42,334	65,466
	-----	-----	-----	-----
Total	\$14,759	\$17,671	\$53,263	\$85,693
	=====	=====	=====	=====

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Non-performing Assets. The following table sets forth information regarding non-accrual loans, foreclosed real estate owned and loans that are 90 days or more delinquent but on which the Bank was accruing interest at the dates indicated. For the year ended December 31, 2001, interest income that would have been recorded on loans accounted for on a non-accrual basis under the original terms of such loans was \$71,000 of which \$27,000 was collected.

	2001 -----	As of December 31, 2000 1999 1998 -----			1997 -----
	(Dollars In Thousands)				
Loans accounted for on a non-accrual basis:					
Commercial and all other	\$ 64	\$ 64	\$ 64	\$ 65	\$ 963
Real estate	597	518	513	503	1,112
Consumer	11	--	19	20	33
	-----	-----	-----	-----	-----
Total	672	582	596	588	2,108
Accruing loans which are contractually past-due 90 days or more:					
Commercial and all other	--	--	--	--	44
Real estate	--	34	--	--	--
Consumer	11	64	61	34	23

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Total	11	98	61	34	67
Total non-performing loans	683	680	657	622	2,175
Foreclosed real estate	54	27	110	204	537
Total non-performing assets	\$ 737	\$ 707	\$ 767	\$ 826	2,712
Total non-performing loans to total loans	.32%	.31%	.32%	.33%	1.17%
Total non-performing loans to total assets	.20%	.21%	.21%	.22%	.83%
Total non-performing assets to total assets	.21%	.22%	.24%	.30%	1.03%

The recorded investment in impaired loans, not requiring an allowance for loan losses was \$618,000 and \$354,000 at December 31, 2001 and 2000, respectively. The recorded investment in impaired loans requiring an allowance for loan losses was \$64,000 and \$-0- at December 31, 2001 and 2000, respectively. The related allowance for loan losses associated with these loans was \$7,000 and \$-0-, respectively, at December 31, 2001 and 2002. For the years, ended December 31, 2001, 2000 and 1999, the average recorded investment in these impaired loans was \$694,000, \$364,000 and \$365,000 and the interest income recognized on these impaired loans was \$22,000, \$-0- and \$-0-, respectively.

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Potential Problem Loans. As of December 31, 2001, there were no loans not previously disclosed, where known information about possible credit problems of borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms.

Analysis of the Allowance for Loan Losses. The following table sets forth information with respect to the Bank's allowance for loan losses for the years indicated:

	Years Ended December 31,			
	2001	2000	1999	1998
Total loans receivable net of unearned Income	\$ 214,194	\$ 216,477	\$ 205,160	\$ 186,000
Average loans receivable	214,905	211,174	196,005	186,000
Allowance balance at beginning of period	\$ 3,300	\$ 3,344	\$ 3,333	\$ 3,333
Charge-offs:				
Commercial and all other	(12)	--	(12)	(12)
Real Estate	(11)	(9)	(17)	(17)
Consumer	(711)	(589)	(419)	(419)
Leases	(152)	(170)	(184)	(184)
Total	(886)	(768)	(632)	(632)

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Recoveries:				
Commercial and all other	8	54	74	
Real Estate	1	73	--	
Consumer	85	88	83	
Leasing	13	29	16	
	-----	-----	-----	-----
Total	107	244	173	
	-----	-----	-----	-----
Net Charge-offs	(779)	(524)	(459)	
Provision Expense	695	480	470	
	-----	-----	-----	-----
Allowance balance at end of period	\$ 3,216	\$ 3,300	\$ 3,344	\$ 3,344
	=====	=====	=====	=====
Allowance for loan losses as a percent of total				
Loans outstanding	1.50%	1.52%	1.63%	
	=====	=====	=====	=====
Net loans charged off as a percent of average				
Loans outstanding36%	.25%	.23%	
	=====	=====	=====	=====

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Allocation of the Allowance For Loan Losses. The following table sets forth the allocation of the Bank's allowance for loan losses by loan category and the percent of loans in each category to total loans at the date indicated.

	At December 31,					
	2001		2000		1999	
	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans
	(Dollars in thousands)					
Commercial, financial and agricultural	\$426	8.1%	\$ 345	7.9%	\$376	7.6%
Real estate - construction	70	2.2	40	1.1	31	1.6
Real estate - mortgage	1,421	59.7	1,314	53.7	1,171	52.8
Consumer loans to individuals	715	27.1	719	31.0	551	26.3
Lease Financing	92	2.9	118	6.3	180	11.7
Unallocated	492	--	764	--	1,035	--
	-----	-----	-----	-----	-----	-----
Total	\$3,216	100.0%	\$3,300	100.0%	\$3,344	100.0%
	=====	=====	=====	=====	=====	=====

(1) Includes specific reserves for assets classified as loss.

Investment Activities

General. The Company maintains a portfolio of investment securities consisting principally of obligations of the U.S. Government and its agencies and obligations of state, counties and municipalities including school districts. The Company considers its investment portfolio a source of earnings and liquidity.

Securities Portfolio. Carrying values of securities at the dates indicated are as follows:

(Dollars in thousands)	As of December 31,		
	2001 ----	2000 ----	1999 ----
Securities: (carrying value)			
U.S. Treasury Securities.....	\$ --	\$ --	\$3,988
U.S. Government Agencies.....	15,647	20,879	18,170
State and political Subdivisions.....	18,866	15,993	12,151
Corporate Notes and bonds.....	14,244	7,953	2,307
Mortgage-backed Securities.....	51,459	38,152	45,523
Equity Securities.....	1,803	1,572	1,632
	-----	-----	-----
Total Securities	\$102,019	\$84,549	\$83,771
	=====	=====	=====
Fair value of Securities.....	\$102,257	\$84,851	\$83,705
	=====	=====	=====

Maturity Distribution of Securities. The following table sets forth certain information regarding carrying values, weighted average yields, and maturities of the Company's securities portfolio at December 31, 2001. Yields on tax-exempt securities are stated on a fully taxable equivalent basis using a Federal tax rate of 34%. Actual maturities may differ from contractual maturities as certain instruments have call features which allow prepayment of obligations. Maturity on mortgage backed securities is based upon expected average lives rather than contractual terms. Equity securities with no stated maturity are classified as "one year or less."

Investment Portfolio Maturities (Dollars in thousands)	One year or Less		After one through five years		After five through ten years		After
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carry Valu
	-----	-----	-----	-----	-----	-----	-----

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Obligations of U.S.							
Government Agencies	\$ --	--	\$ 7,058	5.70%	\$ 7,590	6.19%	\$ 9
Obligations of state and political subdivisions	254	6.36%	1,965	8.38%	796	7.21%	15,8
Mortgage-backed Securities (1)	12,147	5.83%	23,510	5.78%	10,542	5.66%	5,2
Corporate Securities	2,081	7.10%	11,334	5.59%	--	--	8
Equity Securities (2)	1,803	4.35%	--	--	--	--	--
	-----	----	-----	----	-----	----	-----
Total Investment Securities	\$16,285	5.95%	\$43,867	5.84%	\$18,928	5.94%	\$22,9
	=====	=====	=====	=====	=====	=====	=====

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Deposit Activities.

General. The Bank provides a full range of deposit products to its retail and business customers. These include interest-bearing and noninterest bearing transaction accounts, statement savings and money market accounts. Certificate of deposit terms range up to 5 years for retail instruments. The Bank participates in Jumbo CD (\$100,000 and over) markets with local municipalities and school districts which are typically priced on a competitive bid basis. Other services the Bank offers it's customers on a limited basis include cash management, direct deposit and Automated Clearing House (ACH) activity. The Bank operates ten automated teller machines and is affiliated with the STAR ATM network.

The following table sets forth information regarding deposit categories of the Company.

(in thousands)	2001		2000		1999	
	Average		Average		Average	
	Balance	Rate Paid	Balance	Rate Paid	Balance	Rate Paid
Non-interest bearing						
demand	\$ 31,407		\$ 29,525		\$ 28,059	
Interest-bearing demand	31,889	1.22%	28,789	1.80%	25,336	1.68%
Savings	42,631	1.86%	42,492	2.20%	42,676	2.19%
Time	122,161	5.18%	111,778	5.45%	107,152	5.15%

Maturities of Time Deposits. The following table indicates the amount of the Bank's certificates of deposit in amounts of \$100,000 or more and other time deposits of \$100,000 or more by time remaining until maturity as of December 31, 2001.

(Dollars in thousands)	Certificates of Deposit

Maturity Period	

Within three months.....	\$8,936

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Over three through six months.....	9,350
Over six through twelve months.....	1,998
Over twelve months.....	7,140

	\$27,424
	=====

Short-Term Borrowings

The following table sets forth information concerning only short-term borrowings (those maturing within one year) which consist principally of federal funds purchased, securities sold under agreements to repurchase, Federal Home Loan Bank advances and U.S. Treasury demand notes, that the Company had during the periods indicated.

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(Dollars in thousands)	Years ended December 31,		
	2001	2000	1999
	----	----	----
Short term borrowings:			
Average balance during the year.....	\$7,781	\$6,914	\$8,187
Maximum month-end during the year.....	9,411	9,347	8,600
Average interest rate during the year	3.80%	4.38%	3.66%
Total short-term borrowings at end of the year.....	\$6,641	\$7,860	\$8,600

Trust Activities

The Bank operates a Trust Department which provides estate planning, investment management and financial planning to customers. At December 31, 2001, the Bank acted as trustee for \$57.5 million of assets of which \$28.6 million is non-discretionary with no investment authority.

Subsidiary Activities

The Bank, a Pennsylvania chartered bank, is the only wholly owned subsidiary of the Company. Norwood Investment Corp. (NIC), incorporated in 1996, a Pennsylvania licensed insurance agency, is a wholly-owned subsidiary of the Bank. NIC's business is annuity and mutual fund sales and discount brokerage activities primarily to customers of the Bank. The annuities, mutual funds and other investment products are not insured by the FDIC or any other government agency. They are not deposits, obligations of or guaranteed by any bank. The securities are offered through Futureshare Financial a registered broker/dealer. NIC had sales volume of \$9.2 million in 2001, generating revenues for the Company of \$267,000.

WCB Realty Corp. is a wholly-owned real estate subsidiary of the Bank whose principal asset is the administrative offices of the Company.

WTRO Properties Inc. is a wholly-owned real estate subsidiary of the Bank established to hold title to certain real estate upon which the Bank through WTRO foreclosed upon in 1998. The majority of the foreclosed real estate was sold in the third quarter of 1998. The Company had little activity in 2001.

Regulation

Set forth below is a brief description of certain laws which relate to the regulation of the Registrant and the Bank. The description does not purport

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to be complete and is qualified in its entirety by reference to applicable laws and regulations.

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Regulation of the Company

General. The Company, as a bank holding company under the Bank Holding Company Act of 1956, as amended ("BHCA"), is subject to regulation and supervision by the Board of Governors of the Federal Reserve System ("Federal Reserve") and by the Pennsylvania Department of Banking (the "Department"). The Company is required to file annually a report of its operations with, and is subject to examination by, the Federal Reserve and the Department. This regulation and oversight is generally intended to ensure that the Company limits its activities to those allowed by law and that it operates in a safe and sound manner without endangering the financial health of its subsidiary banks.

Under the BHCA, the Company must obtain the prior approval of the Federal Reserve before it may acquire control of another bank or bank holding company, merge or consolidate with another bank holding company, acquire all or substantially all of the assets of another bank or bank holding company, or acquire direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company would directly or indirectly own or control more than 5% of such shares.

Federal statutes impose restrictions on the ability of a bank holding company and its nonbank subsidiaries to obtain extensions of credit from its subsidiary bank, on the subsidiary bank's investments in the stock or securities of the holding company, and on the subsidiary bank's taking of the holding company's stock or securities as collateral for loans to any borrower. A bank holding company and its subsidiaries are also prevented from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property, or furnishing of services by the subsidiary bank.

A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the policy of the Federal Reserve that a bank holding company should stand ready to use available resources to provide adequate capital to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve regulations, or both.

Non-Banking Activities. The business activities of the Company, as a bank holding company, are restricted by the BHCA. Under the BHCA and the Federal Reserve's bank holding company regulations, the Company may only engage in, or acquire or control voting securities or assets of a company engaged in, (1) banking or managing or controlling banks and other subsidiaries authorized under the BHCA and (2) any BHCA activity the Federal Reserve has determined to be so closely related to banking or managing or controlling banks to be a proper incident thereto. These include any incidental activities necessary to carry on those activities, as well as a lengthy list of activities that the Federal Reserve has determined to be so closely related to the business of banking as to be a proper incident thereto.

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Financial Modernization. The Gramm-Leach-Bliley Act, permits greater affiliation among banks, securities firms, insurance companies, and other companies under a new type of financial services company known as a "financial holding company." A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities. The Act also permits the Federal Reserve and the Treasury Department to authorize additional activities for financial holding companies if they are "financial in nature" or "incidental" to financial activities. A bank holding company may become a financial holding company ("FHC") if each of its subsidiary banks is well capitalized, well managed, and has at least a "satisfactory" CRA rating. A financial holding company must provide notice to the Federal Reserve within 30 days after commencing activities previously determined by statute or by the Federal Reserve and Department of the Treasury to be permissible. The Company has not submitted notice to the Federal Reserve of its intent to be deemed a financial holding company.

Regulatory Capital Requirements. The Federal Reserve has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve's capital adequacy guidelines are similar to those imposed on the Bank by the Federal Deposit Insurance Corporation. See "Regulation of the Bank-Regulatory Capital Requirements."

Regulation of the Bank

General. As a Pennsylvania chartered, insured commercial bank, the Bank is subject to extensive regulation and examination by the Department and by the FDIC, which insures its deposits to the maximum extent permitted by law. The federal and state laws and regulations applicable to banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds and the nature and amount of collateral for certain loans. The laws and regulations governing the Bank generally have been promulgated to protect depositors and not for the purpose of protecting stockholders. This regulatory structure also gives the federal and state banking agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Department, the FDIC or the United States Congress, could have a material impact on the Company, the Bank and their operations.

Pennsylvania Banking Law. The Pennsylvania Banking Code ("Banking Code") contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, and employees, as well as corporate powers, savings and investment operations and other aspects of the Bank and its affairs. The Banking Code delegates extensive rule-making power and administrative discretion to the Department so that the supervision and regulation of state chartered banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

The Federal Deposit Insurance Corporation Act ("FDIA"), however, prohibits state chartered banks from making new investments, loans, or becoming

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involved in activities as principal and equity investments which are not permitted for national banks unless (1) the FDIC determines the activity or investment does not pose a significant risk of loss to the BIF and (2) the bank meets all applicable capital requirements. Accordingly, the additional operating authority provided to the Bank by the Banking Code is significantly restricted by the FDIA.

Federal Deposit Insurance. The FDIC is an independent federal agency that insures the deposits, up to prescribed statutory limits, of federally insured banks and savings institutions and safeguards the safety and soundness of the banking and savings industries. The FDIC administers two separate insurance funds, the BIF, which generally insures commercial bank and state savings bank deposits, and the Savings Insurance Fund ("SAIF"), which generally insures savings association deposits. The Bank is a member of the BIF and its deposit accounts are insured by the FDIC, up to prescribed limits.

The FDIC is authorized to establish separate annual deposit insurance assessment rates for members of the BIF and the SAIF, and to increase assessment rates if it determines such increases are appropriate to maintain the reserves of either insurance fund. In addition, the FDIC is authorized to levy emergency special assessments on BIF and SAIF members. The FDIC has set the deposit insurance assessment rates for BIF-member institutions for the first six months of 2001 at 0% to .027% of insured deposits on an annualized basis, with the assessment rate for most institutions set at 0%.

In addition, all insured institutions of the FDIC are required to pay assessments at an annual rate of approximately .0212% of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the Federal government established to recapitalize the predecessor to the SAIF. These assessments will continue until the Financing Corporation bonds mature in 2017.

Regulatory Capital Requirements. The FDIC has promulgated capital adequacy requirements for state-chartered banks that, like the Bank, are not members of the Federal Reserve System. At December 31, 2001, the Bank exceeded all regulatory capital requirements and was classified as "well capitalized."

The FDIC's capital regulations establish a minimum 3% Tier I leverage capital requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively increases the minimum Tier I leverage ratio for such other banks to 4% to 5%. Under the FDIC's regulation, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System. Tier I or core capital is defined as the sum of common stockholders' equity (including retained earnings), noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain purchased mortgage servicing rights and purchased credit and relationships.

The FDIC's regulations also require that state-chartered, non-member banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of total capital (which is defined as Tier I capital and supplementary (Tier 2) capital) to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on

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the risks the FDIC believes are inherent in the type of asset or item. The components of Tier I capital for the risk-based standards are the same as those for the leverage capital requirement. The components of supplementary (Tier 2) capital include cumulative perpetual preferred stock, mandatory subordinated debt, perpetual subordinated debt, intermediate-term preferred stock, up to 45% of unrealized gains on equity securities and a bank's allowance for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of supplementary capital that may be included in total capital is limited to 100% of Tier I capital.

A bank that has less than the minimum leverage capital requirement is subject to various capital plan and activities restriction requirements. The FDIC's regulations also provide that any insured depository institution with a ratio of Tier I capital to total assets that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the FDIA and could be subject to potential termination of deposit insurance.

The Bank is also subject to minimum capital requirements imposed by the Department on Pennsylvania-chartered depository institutions. Under the Department's capital regulations, a Pennsylvania bank or savings bank must maintain a minimum leverage ratio of Tier 1 capital (as defined under the FDIC's capital regulations) to total assets of 4%. In addition, the Department has the supervisory discretion to require a higher leverage ratio for any institutions based on the institution's substandard performance in any of a number of areas. The Bank was in compliance in both the FDIC and Pennsylvania capital requirements as of December 31, 2001.

Affiliate Transaction Restrictions. Federal laws strictly limit the ability of banks to engage in transactions with their affiliates, including their bank holding companies. Such transactions between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of a bank subsidiary's capital and surplus and, with respect to such parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary's capital and surplus. Further, loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that all transactions between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

Federal Home Loan Bank System. The Bank is a member of the FHLB of Pittsburgh, which is one of 12 regional FHLBs. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the Board of Trustees of the FHLB.

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As a member, the Bank is required to purchase and maintain stock in the FHLB of Pittsburgh in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of the Bank's outstanding advances from the FHLB. At December 31, 2001, the Bank was in compliance with this requirement.

Federal Reserve System. The Federal Reserve requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking and NOW accounts) and non-personal time deposits. The balances maintained to meet the reserve

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requirements imposed by the Federal Reserve may be used to satisfy the liquidity requirements that are imposed by the Department. At December 31, 2000, the Bank met its reserve requirements.

Restrictions on Dividends. The Pennsylvania Banking Code states, in part, that dividends may be declared and paid only out of accumulated net earnings and may not be declared or paid unless surplus (retained earnings) is at least equal to contributed capital. The Bank has not declared or paid any dividends which cause the Bank's retained earnings to be reduced below the amount required. Finally, dividends may not be declared or paid if the Bank is in default in payment of any assessment due the FDIC.

The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve's view that a bank holding company should pay cash dividends only to the extent that the holding company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The Federal Reserve also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the federal prompt corrective action regulations, the Federal Reserve may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized."

Item 2. Description of Properties

The Bank operates from its main office located at 717 Main Street, Honesdale, Pennsylvania and nine additional branch offices. The Bank's total investment in office property and equipment is \$ 11.1 million with a net book value of \$6.0 million at December 31, 2001. The Bank currently operates automated teller machines at all ten of its facilities and one automated teller machine only location. The Bank leases three of its locations with minimum lease commitments of \$384,000 through 2006. The three locations have various renewal options.

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Item 3. Legal Proceedings

Neither the Company nor its subsidiaries are involved in any pending legal proceedings, other than routine legal matters occurring in the ordinary course of business, which in the aggregate involve amounts which are believed by management to be immaterial to the consolidated financial condition or results of operations of the Company.

Item 4. Submission of Matters to a Vote of Security-Holders

None.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

Information relating to the market for Registrant's common equity and

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related stockholder matters appears under "Market and Dividend Information" in the Registrant's Annual Report to Stockholders for the fiscal year ended December 31, 2001("Annual Report") and is incorporated herein by reference.

Item 6. Selected Financial Data

The above-captioned information appears under "Selected Financial and Other Data" in the Annual Report, and is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Conditions and Results

of Operations

The above-captioned information appears under Management's Discussion and Analysis of Financial Condition and Results of Operations in the Annual Report and is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

The above-captioned information appears under Management's Discussion and Analysis of Financial Condition and Results of Operations in the Annual Report and is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

The Company's consolidated financial statements listed in Item 14 are incorporated herein by reference.

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Item 9. Changes In and Disagreements with Accountants on Accounting and

Financial Disclosure

None

PART III

Item 10. Directors and Executive Officers of the Registrant

The information contained under the sections captioned "Section 16(a) Beneficial Ownership Reporting Compliance" and "Proposal I-- Election of Directors" in the 2002 Proxy Statement are incorporated herein by reference.

Item 11. Executive Compensation

The information contained under the section captioned "Director and Executive Compensation" in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

(a) Security Ownership of Certain Beneficial Owners

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Information required by this item is incorporated herein by reference to the Section captioned "Voting Securities and Principal Holders Thereof-- Security Ownership of Certain Beneficial Owners" of the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the sections captioned "Voting Securities and Principal Holders Thereof -- Security Ownership of Certain Beneficial Owners" and "Proposal I -- Election of Directors" of the Proxy Statement.

(c) Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.

Item 13. Certain Relationships and Related Transactions

The information required by this item is incorporated herein by reference to the section in the Proxy Statement captioned "Certain Relationships and Related Transactions".

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Part IV

Item 14. Exhibits, Financial Statements, and Reports on Form 8-K

(a) Listed below are all financial statements and exhibits filed as part of this report, and are incorporated by reference.

1. The consolidated balance sheets of Norwood Financial Corp. and subsidiary as of December 31, 2001 and 2000, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three year period ended December 31, 2001, together with the related notes and the independent auditors' report of Beard Miller Company LLP. independent accountants.

2. Schedules omitted as they are not applicable.

3. Exhibits

- 3(i) Articles of Incorporation of Norwood Financial Corp.*
- 3(ii) Bylaws of Norwood Financial Corp.*
- 4.0 Specimen Stock Certificate of Norwood Financial Corp.*
- 10.1 Amended Employment Agreement with William W.Davis, Jr.***
- 10.2 Amended Employment Agreement with Lewis J. Critelli***
- 10.3 Form of Change-in-Control Severance Agreement with nine key employees
- 10.4 Consulting Agreement with Russell L. Ridd**
- 10.5 Wayne Bank Stock Option Plan*
- 10.6 Salary Continuation Agreement between the Bank and William W. Davis, Jr.***

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- 10.7 Salary Continuation Agreement between the Bank and Lewis J. Critelli***
- 10.8 Salary Continuation Agreement between the Bank and Edward C. Kasper***
- 10.9 1999 Directors Stock Compensation Plan***
- 13 Portions of the Annual Report to Stockholders
- 21 Subsidiaries of Norwood Financial Corp.
(see Item 1. Business General and Subsidiary Activity)
- 23 Consent of Independent Accountants.

(b) Reports on Form 8K - None

* Incorporated herein by reference into this document from the Exhibits to Form 10, Registration Statement initially filed with the Commission on April 29, 1996, Registration No.6-28366.

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** Incorporated herein by reference into this document from the Exhibits to the Registrant's Form 10-K filed with the Commission on March 31, 1997, File No. 0-28366.

*** Incorporated herein by reference into this document from the Exhibits to the Registrant's Form 10-K filed with the Commission on March 23, 2001, File No. 0-28366.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

NORWOOD FINANCIAL CORP.

Dated: March 22, 2002

By: /s/William W. Davis, Jr.

William W. Davis, Jr.
President, Chief Executive
Officer and Director
(Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this Report has been signed below on March 22, 2002 by the following persons on behalf of the Registrant and in the capacities indicated.

By: /s/William W. Davis, Jr.

William W. Davis, Jr.

By: /s/Lewis J. Critelli

Lewis J. Critelli

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President, Chief Executive Officer
and Director
(Principal Executive Officer)

Executive Vice President
(Principal Financial and Accounting
Officer)

By: /s/Charles E. Case

Charles E. Case
Director

By: /s/John E. Marshall

John E. Marshall
Director

By: /s/Daniel J. O'Neill

Daniel J. O'Neill
Director

By: /s/Dr. Kenneth A. Phillips

Dr. Kenneth A. Phillips
Director

By: /s/Gary P. Rickard

Gary P. Rickard
Director

By: /s/Russell L. Ridd

Russell L. Ridd
Director

By: /s/Harold A. Shook

Harold A. Shook
Director

By: /s/Richard L. Snyder

Richard L. Snyder
Director