PENNS WOODS BANCORP INC
Form 10-Q
November 07, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended September 30, 2006,**

o **Transition report pursuant to Section 13 or 15 (d) of the Exchange Act for the Transition Period from to .**

No. 0-17077

(Commission File Number)

PENNS WOODS BANCORP, INC.

(Exact name of Registrant as specified in its charter)

PENNSYLVANIA	**23-2226454**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
300 Market Street, Williamsport, Pennsylvania	**17701-0967**
(Address of principal executive offices)	(Zip Code)

(570) 322-1111

Registrant s telephone number, including area code

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

YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO x

On November 1, 2006 there were 3,916,413 shares of the Registrant s common stock outstanding.

PENNS WOODS BANCORP, INC.

INDEX TO QUARTERLY REPORT ON FORM 10-Q

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNS WOODS BANCORP, INC.

CONSOLIDATED BALANCE SHEET

(UNAUDITED)

(In Thousands, Except Share Data)	September 30, 2006	December 31, 2005
ASSETS		
Noninterest-bearing balances	$ 13,371	$ 14,065
Interest-bearing deposits in other financial institutions	97	25
Total cash and cash equivalents	13,468	14,090
Investment securities, available for sale, at fair value	184,484	187,018
Investment securities held to maturity (fair value of $285 and $238)	282	265
Loans held for sale	4,746	3,545
Loans	356,556	338,438
Less: Allowance for loan losses	4,045	3,679
Loans, net	352,511	334,759
Premises and equipment, net	6,627	6,409
Accrued interest receivable	2,720	2,828
Bank-owned life insurance	11,202	10,718
Investment in limited partnerships	4,927	3,549
Goodwill	3,032	3,032
Other assets	2,753	2,455
TOTAL ASSETS	$ 586,752	$ 568,668
LIABILITIES		
Interest-bearing deposits	$ 332,310	$ 281,150
Noninterest-bearing deposits	69,412	71,142
Total deposits	401,722	352,292
Short-term borrowings	18,026	54,003
Long-term borrowings, Federal Home Loan Bank (FHLB)	82,878	84,478
Accrued interest payable	1,510	1,108
Other liabilities	7,891	2,868
TOTAL LIABILITIES	512,027	494,749
SHAREHOLDERS EQUITY		
Common stock, par value $8.33, 10,000,000 shares authorized; 4,002,580 and 4,002,159 shares issued	33,354	33,351
Additional paid-in capital	17,784	17,772
Retained earnings	25,208	22,938
Accumulated other comprehensive income	1,674	850
Less: Treasury stock at cost, 86,372 and 26,372 shares	(3,295)	(992)
TOTAL SHAREHOLDERS EQUITY	74,725	73,919
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 586,752	$ 568,668

See accompanying notes to the unaudited consolidated financial statements.

PENNS WOODS BANCORP, INC.

CONSOLIDATED STATEMENT OF INCOME

(UNAUDITED)

(In Thousands, Except Per Share Data)	**Three Months Ended September 30, 2006**	**2005**	**Nine Months Ended September 30, 2006**	**2005**
INTEREST AND DIVIDEND INCOME				
Loans including fees	$ 6,355	$ 5,602	$ 18,250	$ 16,341
Investment Securities:				
Taxable	874	966	2,691	3,420
Tax-exempt	1,004	969	2,993	2,246
Dividend and other interest income	314	279	982	898
TOTAL INTEREST AND DIVIDEND INCOME	8,547	7,816	24,916	22,905
INTEREST EXPENSE				
Deposits	2,447	1,537	6,252	4,151
Short-term borrowings	306	199	1,221	545
Long-term borrowings, FHLB	954	965	2,844	2,711
TOTAL INTEREST EXPENSE	3,707	2,701	10,317	7,407
NET INTEREST INCOME	4,840	5,115	14,599	15,498
PROVISION FOR LOAN LOSSES	89	180	485	540
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,751	4,935	14,114	14,958
NON-INTEREST INCOME				
Deposit service charges	596	612	1,773	1,603
Securities gains, net	561	556	1,385	1,854
Bank-owned life insurance	94	288	272	475
Gain on sale of loans	264	263	624	631
Insurance commissions	502	507	1,732	1,802
Other	370	321	1,154	964
TOTAL NON-INTEREST INCOME	2,387	2,547	6,940	7,329
NON-INTEREST EXPENSE				
Salaries and employee benefits	2,174	2,096	6,620	6,225
Occupancy, net	308	261	826	838
Furniture and equipment	309	262	894	717
Pennsylvania shares tax	151	138	447	417
Other	1,172	1,031	3,356	3,035
TOTAL NON-INTEREST EXPENSE	4,114	3,788	12,143	11,232
INCOME BEFORE INCOME TAX PROVISION	3,024	3,694	8,911	11,055
INCOME TAX PROVISION	560	746	1,558	2,632
NET INCOME	$ 2,464	$ 2,948	$ 7,353	$ 8,423
EARNINGS PER SHARE - BASIC	$ 0.63	$ 0.74	$ 1.87	$ 2.12
EARNINGS PER SHARE - DILUTED	$ 0.63	$ 0.74	$ 1.87	$ 2.12
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC	3,927,261	3,972,862	3,942,533	3,973,455
WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED	3,927,740	3,974,956	3,943,016	3,975,769
DIVIDENDS PER SHARE	$ 0.44	$ 0.39	$ 1.29	$ 1.15

See accompanying notes to the unaudited consolidated financial statements.

PENNS WOODS BANCORP, INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(UNAUDITED)

(In Thousands Except Per Share Data)	COMMON STOCK SHARES	AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME	TREASURY STOCK	TOTAL SHAREHOLDERS EQUITY
Balance, December 31, 2005	4,002,159	$ 33,351	$ 17,772	$ 22,938	$ 850	$ (992)	$ 73,919
Comprehensive Income:							
Net income				7,353			7,353
Net change in unrealized gain on investments available for sale, net of reclassification adjustment, net of income tax of $424					824		824
Total comprehensive income							8,177
Dividends declared, ($1.29 per share)				(5,083)			(5,083)
Purchase of treasury stock (60,000 shares)						(2,303)	(2,303)
Common shares issued for employee stock purchase plan	421	3	12				15
Balance, September 30, 2006	4,002,580	$ 33,354	$ 17,784	$ 25,208	$ 1,674	$ (3,295)	$ 74,725

	COMMON STOCK SHARES	AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME	TREASURY STOCK	TOTAL SHAREHOLDERS EQUITY
Balance, December 31, 2004	3,998,204	$ 33,318	$ 17,700	$ 18,262	$ 4,331	$ (446)	$ 73,165
Comprehensive Income:							
Net income				8,423			8,423
Net change in unrealized loss on investments available for sale, net of reclassification adjustment, net of income tax benefit of $1,245					(2,417)		(2,417)
Total comprehensive income							6,006
Dividends declared, ($1.15 per share)				(4,583)			(4,583)
Purchase of treasury stock (3,000 shares)						(115)	(115)
Stock options exercised	675	6	11				17
Balance, September 30, 2005	3,998,879	$ 33,324	$ 17,711	$ 22,102	$ 1,914	$ (561)	$ 74,490

See accompanying notes to the unaudited consolidated financial statements.

PENNS WOODS BANCORP, INC.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(UNAUDITED)

(In Thousands)	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005

Net Income	$ 2,464	$ 2,948	$ 7,353	$ 8,423
Other comprehensive income (loss):				
Net unrealized gains (losses) on available for sale securities	5,026	(3,350)	2,633	(1,808)
Less: Reclassification adjustment for net gains included in net income	561	556	1,385	1,854
Other comprehensive income (loss) before tax	4,465	(3,906)	1,248	(3,662)
Income tax expense (benefit) related to other comprehensive income (loss)	1,518	(1,328)	424	(1,245)
Other comprehensive income (loss), net of tax	2,947	(2,578)	824	(2,417)
Comprehensive income	$ 5,411	$ 370	$ 8,177	$ 6,006

See accompanying notes to the unaudited consolidated financial statements.

PENNS WOODS BANCORP, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

(In Thousands)	Nine Months Ended September 30, 2006	2005
OPERATING ACTIVITIES		
Net Income	$ 7,353	$ 8,423
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	549	377
Provision for loan losses	485	540
Accretion and amortization of investment security discounts and premiums	(575)	(319)
Securities gains, net	(1,385)	(1,854)
Originations of loans held for sale	(28,031)	(21,562)
Proceeds of loans held for sale	27,454	22,909
Gain on sale of loans	(624)	(631)
Earnings on bank-owned life insurance	(272)	(475)
Other, net	(80)	200
Net cash provided by operating activities	4,874	7,608
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from sales	39,056	113,007
Proceeds from calls and maturities	5,445	10,697
Purchases	(33,972)	(133,687)
Investment securities held to maturity:		
Proceeds from calls and maturities	25	327
Purchases	(25)	(35)
Net increase in loans	(18,288)	(6,918)
Acquisition of bank premises and equipment	(767)	(1,636)
Proceeds from the sale of foreclosed assets	83	67
Investment in limited partnership	(1,535)	(3,124)
Net cash used for investing activities	(9,978)	(21,302)
FINANCING ACTIVITIES		
Net increase in interest-bearing deposits	51,160	8,351
Net decrease in noninterest-bearing deposits	(1,730)	(1,997)
Proceeds of long-term borrowings		10,000
Repayment of long-term borrowings	(1,600)	(1,400)
Net (decrease) increase in short-term borrowings	(35,977)	3,935
Dividends paid	(5,083)	(4,583)
Issuance of common stock	15	
Stock options exercised		17
Purchase of treasury stock	(2,303)	(115)
Net cash provided by financing activities	4,482	14,208
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(622)	514
CASH AND CASH EQUIVALENTS, BEGINNING	14,090	12,626
CASH AND CASH EQUIVALENTS, ENDING	$ 13,468	$ 13,140
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Interest paid	$ 9,915	$ 7,139
Income taxes paid	2,075	2,475
Transfer of loans to foreclosed assets	51	386

See accompanying notes to the unaudited consolidated financial statements.

PENNS WOODS BANCORP, INC. AND SUBSIDIARIES

NOTES TO

CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The consolidated financial statements include the accounts of Penns Woods Bancorp, Inc. (the Company) and its wholly-owned subsidiaries: Woods Investment Company, Inc., Woods Real Estate Development Company, Inc., and Jersey Shore State Bank (the Bank) and its wholly-owned subsidiary The M Group, Inc. D/B/A The Comprehensive Financial Group (The M Group). All significant inter-company balances and transactions have been eliminated in the consolidation.

The interim financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary for the fair presentation of results for such periods. All of those adjustments are of a normal, recurring nature. The results of operations for any interim period are not necessarily indicative of results for the full year. These financial statements should be read in conjunction with financial statements and notes thereto contained in the Company s annual report for the year ended December 31, 2005.

The accounting policies followed in the presentation of interim financial results are the same as those followed on an annual basis. These policies are presented on pages 38 thru 43 of the Annual Report on Form 10-K for the year ended December 31, 2005.

Note 2. Recent Accounting Pronouncements

In September 2006, the FASB issued *FAS No. 157, Fair Value Measurements*, which provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The Standard does not expand the use of fair value in any new circumstances. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Early adoption is permitted. The adoption of this standard is not expected to have a material effect on the Company s results of operations or financial position.

In September 2006, the FASB issued *FAS No. 158, Employers Accounting for Defined Benefit Pension and Other Post Retirement Plans*, an amendment of FASB Statements No. 87, 88, 106, and 132(R). FAS No. 158 requires that a company recognize the overfunded or underfunded status of its defined benefit post retirement plans (other than multiemployer plans) as an asset or liability in its statement of financial position and that it recognize changes in the funded status in the year in which the changes occur through other comprehensive income. FAS No. 158 also requires the measurement of defined benefit plan assets and obligations as of the fiscal year end, in addition to footnote disclosures. FAS No. 158 is effective for fiscal years ending after December 15, 2006. The Company is currently evaluating the impact the adoption of the standard will have on the Company s financial position.

In September 2006, the SEC issued *Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*, providing guidance on quantifying financial statement misstatement and implementation when first applying this guidance. Under SAB No. 108, companies should evaluate a misstatement based on its impact on the current year income statement, as well as the cumulative effect of correcting such misstatements that existed in prior years existing in the current year s ending balance sheet. SAB 108 is effective for fiscal years ending after November 15, 2006. The adoption of this bulletin is not expected to have a material effect on the Company s results of operations or financial position.

In September 2006, the FASB reached consensus on the guidance provided by *Emerging Issues Task Force Issue 06-4 (EITF 06-4), Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policy, that are associated with a postretirement benefit. EITF 06-4 requires that for a split-dollar life insurance arrangement within the scope of the Issue, an employer should recognize a liability for future benefits in accordance with FAS No. 106 (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact the adoption of the standard will have on the Company s results of operations or financial condition.

In September 2006, the FASB reached consensus on the guidance provided by *Emerging Issues Task Force Issue 06-5(EITF 06-5), Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance*. EITF 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF 06-5 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact the adoption of the standard will have on the Company s results of operations or financial condition.

Note 3. Per Share Data

The following table sets forth the composition of the weighted average common shares (denominator) used in the basic and dilutive per share computation. There are no convertible securities which would affect the numerator in calculating basic and diluted earnings per share; therefore, net income as presented on the consolidated statement of income will be used as the numerator.

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Weighted average common shares outstanding	4,002,340	3,986,506	4,002,220	3,986,256
Average treasury stock shares	(75,079)	(13,644)	(59,687)	(12,801)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	3,927,261	3,972,862	3,942,533	3,973,455
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	479	2,094	483	2,314
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	3,927,740	3,974,956	3,943,016	3,975,769

Options to purchase 8,999 shares and 9,728 shares of common stock at the price of $40.29 were outstanding during the three and nine months ended September 30, 2006 and 2005, respectively, but were not included in the computation of diluted earnings per share as they were anti-dilutive due to the strike price being greater than the market price as of September 30, 2006 and 2005, respectively.

Note 4. Net Periodic Benefit Cost-Defined Benefit Plans

For a detailed disclosure on the Company s pension and employee benefits plans, please refer to Note 11 of the Company s Consolidated Financial Statements included in the 2005 Annual Report on Form 10-K.

The following sets forth the components of the net periodic benefit cost of the domestic non-contributory defined benefit plan for the three and nine months ended September 30, 2006 and 2005, respectively.

(In Thousands)	**Three Months Ended September 30, 2006**	**2005**	**Nine Months Ended September 30, 2006**	**2005**
Service cost	$ 117	$ 125	$ 350	$ 379
Interest cost	108	110	325	335
Expected return on plan assets	(121)	(112)	(364)	(302)
Amortization of transition	(1)	(1)	(2)	(2)
Amortization of prior service cost	6	6	19	19
Amortization of net loss	6	16	17	49
Net periodic cost	$ 115	$ 144	$ 345	$ 478

Employer Contributions

The Company previously disclosed in its consolidated financial statements, included in the 2005 Annual Report on Form 10-K, that it expected to contribute $500,000 to its defined benefit plan in 2006. As of September 30, 2006, a contribution in the amount of $550,000 was made for the 2005 plan year with no additional contributions anticipated.

Note 5. Off Balance Sheet Risk

The Company 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 are primarily comprised of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit, interest rate, or liquidity risk in excess of the amount recognized in the consolidated balance sheet. The contract amounts of these instruments express the extent of involvement the Company has in particular classes of financial instruments.

The Company s exposure to credit loss from nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company may require collateral or other security to support financial instruments with off-balance sheet credit risk.

Outstanding financial instruments with off balance sheet risk are as follows:

(In Thousands)	September 30, 2006	December 31, 2005
Commitments to extend credit	$ 70,469	$ 72,583
Standby letters of credit	1,041	2,193

Note 6. Reclassification of Comparative Amounts

Certain comparative amounts for the prior periods have been reclassified to conform to current period presentations. Such reclassifications had no effect on net income or shareholders equity.

Note 7. Stock Split

During the fourth quarter of 2005 the Company initiated a 6 for 5 stock split. Previously reported share and per share amounts have been adjusted to reflect the split.

Note 8. Employee Stock Purchase Plan

Effective April 26, 2006 the Company implemented the Penns Woods Bancorp, Inc. 2006 Employee Stock Purchase Plan (Plan). The Plan is intended to encourage employee participation in the ownership and economic progress of the Company. The Plan allows for up

10

to 1,000,000 shares to be purchased by employees. The purchase price of the shares is 95% of market value with an employee eligible to purchase up to the lesser of 15% of base compensation or $12,000 in market value annually. During the three and nine months ended September 30, 2006 there were 421 shares issued under the plan.

CAUTIONARY STATEMENT FOR PURPOSES OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Report contains certain forward-looking statements including statements concerning plans, objectives, future events or performance and assumptions and other statements which are other than statements of historical fact. The Company wishes to caution readers that the following important factors, among others, may have affected and could in the future affect the Company s actual results and could cause the Company s actual results for subsequent periods to differ materially from those expressed in any forward-looking statement made by or on behalf of the Company herein: (i) the effect of changes in laws and regulations, including federal and state banking laws and regulations, which the Company must comply, and the associated costs of compliance with such laws and regulations either currently or in the future as applicable; (ii) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as by the Financial Accounting Standards Board, or of changes in the Company s organization, compensation and benefit plans; (iii) the effect on the Company s competitive position within its market area of the increasing consolidation within the banking and financial services industries, including the increased competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services; (iv) the effect of changes in interest rates; and (v) the effect of changes in the business cycle and downturns in the local, regional or national economies.

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

EARNINGS SUMMARY

Comparison of the Three and Nine Months Ended September 30, 2006 and 2005

Summary Results

Net income for the three months ended September 30, 2006 was $2,464,000 compared to $2,948,000 for the same period of 2005. Basic and diluted earnings per share for the three months ended September 30, 2006 were $0.63 as compared to $0.74 for the three months ended September 30, 2005. Return on average assets and return on average equity were 1.70% and 13.41% for the three months ended September 30, 2006 as compared to 2.12% and 16.54% for the corresponding period of 2005. Net income from core operations for the three months ended September 30, 2006 and 2005, excluding after-tax net securities gains of $370,000 and $367,000, respectively, were $2,094,000 and $2,581,000.

The nine months ended September 30, 2006 generated net income of $7,353,000 compared to $8,423,000 for the same period of 2005. Earnings per share, basic and diluted, for the nine months ended September 30, 2006 were $1.87 as compared to $2.12 for the comparable period of 2005. Return on average assets and return on average equity were 1.71% and 13.20% for the nine months ended September 30, 2006 as compared to 2.05% and 14.94% for the corresponding period of 2005. Net income from core operations for the nine months ended September 30, 2006, excluding after-tax securities gains of $914,000, declined to $6,439,000 from $7,199,000 for the nine months ended September 30, 2005. (Management uses the non-GAAP measure of net income from core operations in its analysis of the Company s performance. This measure, as used by the Company, adjusts net income by significant gains or losses that are unusual in nature. Because certain of these items and their impact on the Company s performance are difficult to predict, management believes the presentation of financial measures excluding the impact of such items provides useful supplemental information in evaluating the operating results of the Company s core businesses. For purposes of this Quarterly Report on Form 10-Q, net income from core operations means net income adjusted to exclude after-tax net securities gains. These disclosures should not be viewed as a substitute for net income determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.)

Interest Income

Interest income for the three months ended September 30, 2006 increased $731,000 to $8,547,000 as compared to $7,816,000 for the same period of 2005. The increase in total interest income was primarily the result of growth in average loans of $24,037,000 for the three months ended September 30, 2006 as compared to 2005. The average loan growth and a 38 basis point (bp) increase in loan portfolio yields accounted for $753,000 of the total interest income growth. Over this time frame the average balance of investment securities decreased $14,654,000. The decrease in the average investment portfolio was offset by an increase of 43

12

bp in the investment portfolio yield which resulted in total interest income from the investment portfolio declining $28,000 to $2,185,000 for the three months ended September 30, 2006, while interest income on interest bearing deposits increased $6,000 for the same period. On a taxable equivalent basis the interest income from the investment portfolio remained constant at $2,702,000. The increase in dividends received is the result of an increase in the level of dividends from the Federal Home Loan Bank of Pittsburgh coupled with an emphasis on purchasing stocks consistently having an above average dividend yield.

During the nine months ended September 30, 2006, interest income was $24,916,000, an increase of $2,011,000 over the same period in 2005. The reasons for the 8.8% growth in interest income for the nine month period are identical to those for the three month period ending September 30, 2006 discussed above. The growth in average loans of $21,754,000 coupled with a 34 bp increase in the loan portfolio yield resulted in an increase of $1,909,000 in loan interest and fee income. Average investment securities decreased slightly to $184,820,000 resulting in interest income on the investment portfolio increasing $118,000 when compared to September 30, 2005 due to an increase of 44 bp in the investment portfolio yield, while interest income on interest bearing deposits decreased $16,000 for the same period. The asset allocation between loans and the investment portfolio resulted in taxable equivalent interest income increasing $2,462,000 for the nine months ended September 30, 2006 as compared to the same period of 2005.

Interest income composition for the three and nine months ended September 30, 2006 and 2005 were as follows:

	For The Three Months Ended						
	September 30, 2006		**September 30, 2005**		**Change**		
(In Thousands)	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**%**	
Loans including fees	$ 6,355	74.4 %	$ 5,602	71.6 %	$ 753	13.4 %	
Investment securities:							
Taxable	874	10.2	966	12.4	(92)	(9.5)	
Tax-exempt	1,004	11.7	969	12.4	35	3.6	
Dividend and other interest income	314	3.7	279	3.6	35	12.5	
Total interest income	$ 8,547	100.0 %	$ 7,816	100.0 %	$ 731	9.4 %	

	For The Nine Months Ended					
	September 30, 2006		**September 30, 2005**		**Change**	
(In Thousands)	**Amount**	**% Total**	**Amount**	**% Total**	**Amount**	**%**
Loans including fees	$ 18,250	73.3 %	$ 16,341	71.4 %	$ 1,909	11.7 %
Investment securities:						
Taxable	2,691	10.8	3,420	14.9	(729)	(21.3)
Tax-exempt	2,993	12.0	2,246	9.8	747	33.3
Dividend and other interest income	982					