PEOPLES FINANCIAL SERVICES CORP/
Form 10-Q
May 10, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 **March 31, 2007** or
( ) Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the transition period from

No. 0-23863
(Commission File Number)

PEOPLES FINANCIAL SERVICES CORP.
(Exact Name of Registrant as Specified in its Charter)

Pennsylvania (State of Incorporation)	23-2391852 (IRS Employer ID Number)
50 Main Street Hallstead, PA (Address of Principal Executive Offices)	18822 (Zip Code)

(570) 879-2175
(Registrant's Telephone Number)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer _____ Accelerated filer X Non-accelerated filer _____

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

Number of shares outstanding as of April 30, 2007

COMMON STOCK ($2 Par Value) (Title of Class)	3,134,411 (Outstanding Shares)

PEOPLES FINANCIAL SERVICES CORP.
FORM 10-Q

For the Quarter Ended March 31, 2007

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
March 31, 2007 and December 31, 2006

(In thousands, except share and per share data)

ASSETS:		***Mar 2007***		***Dec 2006***
Cash and due from banks	**$**	**5,637**	$	7,527
Interest bearing deposits in other banks		**104**		2,626
Federal funds sold		**6,240**		2,227
Cash and cash equivalents		**11,981**		12,380
Securities available for sale		**99,607**		110,302
Loans		**272,008**		271,175
Allowance for loan losses		**(1,904)**		(1,792)
Loans, net		**270,104**		269,383
Bank premises and equipment, net		**6,142**		6,183
Accrued interest receivable		**1,774**		1,855
Intangible assets		**1,270**		1,331
Other real estate owned		**5,079**		5,062
Other assets		**9,634**		9,772
Total assets	**$**	**405,591**	$	416,268
LIABILITIES:				
Deposits:				
Non-interest bearing	**$**	**51,775**	$	50,940
Interest bearing		**268,684**		272,673
Total deposits		**320,459**		323,613
Accrued interest payable		**609**		703
Short-term borrowings		**9,940**		12,574
Long-term borrowings		**31,896**		36,525
Other liabilities		**1,135**		1,613
Total liabilities		**364,039**		375,028
STOCKHOLDERS' EQUITY				
Common stock, par value $2 per share; authorized 12,500,000 shares; issued 3,341,251 shares; outstanding 3,132,474 shares and 3,133,874 shares at March 31, 2007 and December 31, 2006, respectively		**6,683**		6,683
Surplus		**3,064**		3,046
Retained earnings		**36,864**		36,336
Accumulated other comprehensive loss		**(562)**		(395)
Treasury stock at cost 208,777 and 207,377 shares at March 31, 2007 and December 31, 2006, respectively		**(4,497)**		(4,430)
Total stockholders' equity		**41,552**		41,240
Total liabilities and stockholders’ equity	**$**	**405,591**	$	416,268

See Notes to Consolidated Financial Statements

PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(In thousands, except per share data)	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
INTEREST INCOME:		
Loans receivable, including fees	**$ 4,677**	$ 4,270
Securities:		
Taxable	**955**	675
Tax exempt	**335**	380
Other	**39**	9
Total interest income	**6,006**	5,334
INTEREST EXPENSE:		
Deposits	**2,352**	1,883
Short-term borrowings	**175**	138
Long-term borrowings	**330**	362
Total interest expense	**2,857**	2,383
Net interest income	**3,149**	2,951
PROVISION FOR LOAN LOSSES	**120**	60
Net interest income after provision for loan losses	**3,029**	2,891
OTHER INCOME:		
Customer service fees	**448**	463
Investment division commission income	**79**	49
Earnings on investment in life insurance	**75**	65
Other income	**170**	102
Net realized gains (losses) on sales of securities available for sale	**29**	(17)
Total other income	**801**	662
OTHER EXPENSES:		
Salaries and employee benefits	**1,181**	1,143
Occupancy	**198**	186
Equipment	**129**	105
FDIC insurance and assessments	**37**	33
Professional fees and outside services	**96**	83
Computer services and supplies	**204**	223
Taxes, other than payroll and income	**93**	82
Other	**502**	425
Total other expenses	**2,440**	2,280
Income before income taxes	**1,390**	1,273
INCOME TAXES	**267**	228
Net income	**$ 1,123**	$ 1,045
Net income per share, basic	**$ 0.36**	$ 0.33
Net income per share, diluted	**$ 0.36**	$ 0.33

See Notes to Consolidated Financial Statements

PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006
(UNAUDITED)

(In thousands, except share data)	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, December 31, 2006	**$ 6,683**	**$ 3,046**	**$ 36,336**	**$ (395)**	**$ (4,430)**	**$ 41,240**
Comprehensive income						
Net income	**0**	**0**	**1,123**	**0**	**0**	**1,123**
Net change in unrealized losses on securities available for sale, net of reclassification adjustment and taxes	**0**	**0**	**0**	**(167)**	**0**	**(167)**
Total comprehensive income						**956**
Stock option expense	**0**	**1**	**0**	**0**	**0**	**1**
Cash dividends, ($0.19 per share)	**0**	**0**	**(595)**	**0**	**0**	**(595)**
Treasury stock purchase (3,500 shares)	**0**	**0**	**0**	**0**	**(94)**	**(94)**
Treasury stock issued for stock option plan (2,100 shares)	**0**	**17**	**0**	**0**	**27**	**44**
Balance, March 31, 2007	**$ 6,683**	**$ 3,064**	**$ 36,864**	**$ (562)**	**$ (4,497)**	**$ 41,552**
Balance, December 31, 2005	$ 6,683	$ 2,995	$ 34,599	$ (961)	$ (3,700)	$ 39,616
Comprehensive income						
Net income	0	0	1,045	0	0	1,045
Net change in unrealized losses on securities available for sale, net of reclassification adjustment and taxes	0	0	0	(22)	0	(22)
Total comprehensive income						1,023
Cash dividends, ($0.19 per share)	0	0	(600)	0	0	(600)
Treasury stock purchase (7,300 shares)	0	0	0	0	(230)	(230)
Treasury stock issued for stock option plan (3,725 shares)	0	21	0	0	41	62
Balance, March 31, 2006	$ 6,683	$ 3,016	$ 35,044	$ (983)	$ (3,889)	$ 39,871

See Notes to Consolidated Financial Statements

PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(In thousands)	Three Months Ended	
	March 31, 2007	March 31, 2006
Cash flows from operating activities		
Net Income	**$ 1,123**	$ 1,045
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**221**	201
Provision for loan losses	**120**	60
(Gain) loss on sale of foreclosed real estate	**4**	(29)
Amortization of securities' premiums and accretion of discounts	**71**	118
Amortization of deferred loan costs	**48**	50
Losses (gains) on sales of securities available for sale, net	**(29)**	17
Stock option expense	**1**	0
Proceeds from the sale of mortgage loans	**1,039**	426
Net gain on sale of loans	**(3)**	(7)
Loans originated for sale	**(1,306)**	(419)
Net earnings on investment in life insurance	**(75)**	(65)
(Increase) decrease in accrued interest receivable	**81**	(80)
(Increase) decrease in other assets	**299**	(17)
Decrease in accrued interest payable	**(94)**	(53)
Decrease in other liabilities	**(478)**	(83)
Net cash provided by operating activities	**1,022**	1,164
Cash flows from investing activities		
Proceeds from sale of available for sale securities	**25,640**	12,328
Proceeds from maturities and principal payments on available for sale securities	**8,679**	1,351
Purchase of available for sale securities	**(23,919)**	(5,718)
Net increase in loans	**(655)**	(7,809)
Purchase of premises and equipment	**(119)**	(297)
Proceeds from sale of other real estate	**15**	54
Net cash provided by (used in) investing activities	**9,641**	(91)
Cash flows from financing activities		
Cash dividends paid	**(595)**	(600)
Increase (decrease) in deposits	**(3,154)**	7,877
Proceeds from long-term borrowings	**3,275**	2,200
Repayment of long-term borrowings	**(7,904)**	(300)
Decrease in short-term borrowings	**(2,634)**	(8,119)
Purchase of treasury stock	**(94)**	(230)
Proceeds from sale of treasury stock	**44**	62
Net cash provided by (used in) financing activities	**(11,062)**	890
Net increase (decrease) in cash and cash equivalents	**(399)**	1,963
Cash and cash equivalents, beginning of period	**12,380**	6,696
Cash and cash equivalents, end of period	**$ 11,981**	$ 8,659
Supplemental disclosures of cash paid		
Interest paid	**$ 2,951**	$ 2,436
Income taxes paid	**$ 0**	$ 0

Non-cash investing and financing activities				
Transfers from loans to real estate through foreclosure	**$**	**36**	$	6

See Notes to Consolidated Financial Statements

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NOTE 1. BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Peoples Financial Services Corp. (the “Corporation” or the “Company”) and its wholly owned subsidiaries, Peoples National Bank (the “Bank”) and Peoples Advisors, LLC (“Advisors”). All material intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information, as well as with instructions for Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three-month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year-ended December 31, 2007. For further information, refer to the consolidated financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the year-ended December 31, 2006.

NOTE 2. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended	
	March 31, 2007	March 31, 2006
Net income applicable to common stock	$ 1,123,000	$ 1,045,000
Weighted average common shares outstanding	3,133,304	3,153,948
Effect of dilutive securities, stock options	10,563	14,107
Weighted average common shares outstanding used to calculate diluted earnings per share	3,143,867	3,168,055
Basic earnings per share	$ 0.36	$ 0.33
Diluted earnings per share	$ 0.36	$ 0.33

NOTE 3. OTHER COMPREHENSIVE INCOME

The components of other comprehensive income and related tax effects for the three months ended March 31, 2007 and 2006 are as follows:

(In thousands)	Three Months Ended	
	March 31, 2007	March 31, 2006
Unrealized holding losses on available for sale securities	$ (224)	$ (51)
Less: Reclassification adjustment for gains (losses) realized in net income	29	(17)
Net unrealized losses	(253)	(34)
Tax effect	86	12
Other comprehensive loss	$ (167)	$ (22)

NOTE 4. STOCK BASED COMPENSATION

Prior to January 1, 2006, the Company’s stock option plan was accounted for under the recognition and measurement provisions of APB Opinion No. 25 (Opinion 25), *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by FASB Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock Based Compensation* (as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*) (collectively SFAS 123). No stock-based employee compensation cost was recognized in the Company’s consolidated statements of income through December 31, 2005, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), Share-Based Payment, using the modified-prospective transition method. Under that transition method, compensation cost recognized in 2006 and thereafter includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006 based on the grant date fair value calculated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on a grant-date fair value estimated in accordance with the provisions of SFAS 123(R). As of December 31, 2006, only 4,100 stock options were not fully vested and no stock options were granted during the three months ended March 31, 2007.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company’s earnings before income taxes for the three months ended March 31, 2007, are not materially different than if it had continued to be accounted for as share-based compensation under Opinion 25. As of March 31, 2007, the Company had 4,100 stock options not fully vested and there was $3,500 of total unrecognized compensation cost related to these nonvested options. The cost is expected to be recognized monthly on a straight-line basis through December 31, 2008.

NOTE 5. GUARANTEES

The Company does not issue any guarantees that would require liability recognition or disclosure, other than standby letters of credit. Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Company had $3,136,000 of standby letters of credit as of March 31, 2007. The Company uses the same credit policies in making conditional obligations as it does for on-balance sheet instruments.

The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at March 31, 2007 was $3,136,000, and the approximate value of underlying collateral upon liquidation that would be expected to cover this maximum potential exposure was $1,794,000. The current amount of the liability as of March 31, 2007 for guarantees under standby letters of credit is not material.

NOTE 6. NEW ACCOUNTING STANDARDS

EITF 06-11

In March 2007, the FASB ratified EITF Issue No. 06-11, “Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards.” EITF 06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for nonvested equity-classified employee share-based payment awards as an increase to additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after September 15, 2007. The Company does not expect EITF 06-11 will have a material impact on its financial position, results of operations or cash flows.

EITF 06-10

In March 2007, the FASB ratified Emerging Issues Task Force Issue No. 06-10 “Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements” (EITF 06-10). EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. The Company is currently assessing the impact of EITF 06-10 on its consolidated financial position and results of operations.

EITF 06-5

On September 7, 2006, the EITF reached a conclusion on Issue No. 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”). The scope of EITF 06-5 consists of six separate issues relating to accounting for life insurance policies purchased by entities protecting against the loss of “key persons.” The six issues are clarifications of previously issued guidance on FASB Technical Bulletin No. 85-4. EITF 06-5 is effective for fiscal years beginning after December 15, 2006. Adoption of EITF 06-5 did not have a material impact on the Company’s consolidated financial statements.

SFAS No. 159

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 provides companies with an option to report many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS No. 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The FASB believes that SFAS No. 159 helps to mitigate accounting-induced volatility by enabling companies to report related assets and liabilities at fair value, which would likely reduce the need for companies to comply with detailed rules for hedge accounting. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities, and would require entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157, *Fair Value Measurements.* This statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is in the process of evaluating the impact, if any, that the adoption of SFAS No. 159 will have on the Company's consolidated financial statements.

NOTE 7. SUBSEQUENT EVENT

On April 2, 2007, the Bank formed Peoples Financial Leasing, LLC, a member-managed limited liability company under the laws of the Commonwealth of Pennsylvania, to be a wholly owned subsidiary of the Bank, for the purpose of providing professional and technical services in employee leasing for the Bank.

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

The following discussion and analysis of the consolidated financial statements of the Corporation is presented to provide insight into management's assessment of financial results. The Corporation's two subsidiaries, Peoples National Bank and Peoples Advisors, LLC, provide financial services to individuals and businesses within the Bank's primary market area made up of Susquehanna, Wyoming and Northern Lackawanna Counties in Pennsylvania, and Broome County in New York. The Bank is a member of the Federal Reserve System and subject to regulation, supervision, and examination by the Office of the Comptroller of the Currency. Advisors is a member of the National Association of Securities Dealers (NASD), which also acts as the primary regulator for Advisors.

CAUTIONARY STATEMENT CONCERNING FORWARD LOOKING INFORMATION

Except for historical information, this Report may be deemed to contain "forward looking" information. Examples of forward looking information may include, but are not limited to, (a) projections of or statements regarding future earnings, interest income, other income, earnings or loss per share, asset mix and quality, growth prospects, capital structure and other financial terms, (b) statements of plans and objectives of management or the Board of Directors, (c) statements of future economic performance, and (d) statements of assumptions, such as economic conditions in the market areas served by the Corporation and the Bank, underlying other statements and statements about the Corporation and the Bank or their respective businesses. Such forward looking information can be identified by the use of forward looking terminology such as "believes," "expects," "may," "intends," "will," "should," "anticipates," or the n of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy. No assurance can be given that the future results covered by the forward looking information will be achieved. Such statements are subject to risks, uncertainties, and other factors which could cause actual results to differ materially from future results expressed or implied by such forward looking information. Important factors that could impact operating results include, but are not limited to, (i) the effects of changing economic conditions in both the market areas served by the Corporation and the Bank and nationally, (ii) credit risks of commercial, real estate, consumer and other lending activities, (iii) significant changes in interest rates, (iv) changes in federal and state banking laws and regulations which could affect operations, (v) funding costs, and (vi) other external developments which could materially affect business and operations.

CRITICAL ACCOUNTING POLICIES

Disclosure of the Company's significant accounting policies is included in Note 1 to the consolidated financial statements of the Company's Annual Report on Form 10K for the year-ended December 31, 2006. Some of these policies are particularly sensitive requiring significant judgments, estimates and assumptions to be made by Management. Additional information is contained on page 17 of this report for the provision and allowance for loan losses.

OVERVIEW

Net income for the quarter increased 7.46% to $1.123 million as compared to $1.045 million for the first quarter of 2006. Diluted earnings per share increased 9.09% to $.36 per share for the first quarter of 2007 from $.33 per share in the first quarter of 2006. At March 31, 2007, the Company had total assets of $405.591 million, net loans of $270.104 million, and total deposits of $320.459 million.

FINANCIAL CONDITION

***Cash and Cash Equivalents*:**

At March 31, 2007, cash, federal funds sold, and deposits with other banks totaled $11.981 million as compared to $12.380 million on December 31, 2006. The decrease over the first three months of 2007 has been minimal as the decrease in deposits with other banks has been offset by the increase in federal funds as of March 31, 2007.

Management believes the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, and the portion of the securities and loan portfolios that mature within one year. The current sources of funds will enable the Corporation to meet all its cash obligations as they come due.

***Securities*:**

Securities totaled $99.607 million on March 31, 2007, decreasing by $10.695 million from the December 31, 2006 total of $110.302 million.

The total securities portfolio is held as available for sale. This strategy was implemented in 1995 to provide more flexibility in using the investment portfolio for liquidity purposes as well as providing more flexibility in selling when market opportunities occur.

Securities available for sale are accounted for at fair value with unrealized gains or losses net of deferred income taxes, reported as a separate component of stockholders' equity. The carrying value of securities as of March 31, 2007 included an unrealized loss of $852 thousand reflected as accumulated other comprehensive loss of $562 thousand in stockholders' equity, net of deferred income taxes of $290 thousand. This compares to an unrealized loss of $598 thousand at December 31, 2006 reflected as accumulated other comprehensive loss of $395 thousand, net of deferred income taxes of $203 thousand.

Management monitors the earnings performance and effectiveness of liquidity of the securities portfolio on a monthly basis through the Asset/Liability Committee ("ALCO"). The ALCO also reviews and manages interest rate risk for the Corporation. Through active balance sheet management and analysis of the securities portfolio, the Corporation maintains sufficient liquidity to satisfy depositor requirements and various credit needs of its customers.

Loans:

Net loans increased $721 thousand, or .27%, to $270.104 million as of March 31, 2007 from $269.383 million as of December 31, 2006. Of the loan growth experienced in the first quarter of 2007, the largest was in residential real estate mortgages which increased $941 thousand, or .83%, to $113.824 million as of March 31, 2007 compared to $112.883 million as of December 31, 2006. Commercial loans, including traditional commercial loans and commercial real estate mortgages, decreased $229 thousand, or .16%, to $140.702 million as of March 31, 2007 compared to $140.931 million at year-end December 31, 2006.

Increasing the loan to deposit ratio is a goal of the Bank, but loan quality is always considered in this effort. Management has continued its efforts to create good underwriting standards for both commercial and consumer credit. Most commercial lending is done primarily with locally owned small businesses.

Deposits:

Deposits are attracted from within the Bank's primary market area through the offering of various deposit instruments including NOW accounts, money market accounts, savings accounts, certificates of deposit, and IRA's. During the three-month period ended March 31, 2007, total deposits decreased $3.154 million, or .97%, to $320.459 million compared to $323.613 million as of December 31, 2006. The decrease was concentrated within NOW accounts and money market deposit accounts.

The trend in the first quarter of 2007 is expected due to the nature of those deposits affected. Early in the calendar year tends to be the period where the Bank experiences an outflow of funds due to various reasons, among them are property tax payments and holiday bills which come due after January 1. The outflow of funds was less evident in the latter half of the first quarter.

Borrowings:

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

Total short-term borrowings at March 31, 2007 were $9.940 million as compared to $12.574 million as of December 31, 2006, a decrease of $2.634 million, or 20.95%. Long-term borrowings were $31.896 million as of March 31, 2007 compared to $36.525 million as of December 31, 2006, a decrease of $4.629 million, or 12.67%. The decrease in long-term borrowings included the maturity of $7.500 million in term borrowings which was offset by proceeds of new term borrowings in the amount of $3.275 million at the FHLB.

With the increase to the short end of the yield curve, the certificate savings rate offered by the Bank has attracted a large sum of deposits which have lessened the Bank's reliance on overnight, short-term borrowings.

Capital:

The adequacy of the Corporation's capital is reviewed on an ongoing basis with reference to the size, composition and quality of the Corporation's resources and regulatory guidelines. Management seeks to maintain a level of capital sufficient to support existing assets and anticipated asset growth, maintain favorable access to capital markets, and preserve high quality credit ratings. As of March 31, 2007, regulatory capital to total average assets was 9.14% as compared to 8.92% on December 31, 2006. The Company repurchases its stock in the open market or from individuals as warranted to leverage the capital account and to provide stock for its stock option and dividend reinvestment plans. In the three months ended March 31, 2007, the Company purchased 3,500 shares for the treasury at a total cost of $94,500.

The Corporation has complied with the standards of capital adequacy mandated by the banking regulators. The bank regulators have established "risk-based" capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of various assets the banks hold in their portfolios. A weight category of either 0% (lowest risk asset), 20%, 50%, or 100% (highest risk assets) is assigned to each asset on the balance sheet. Capital is being maintained in compliance with risk-based capital guidelines. The Company's Tier 1 capital to risk weighted asset ratio was 13.13% and the total capital ratio to risk weighted assets ratio was 13.82% at March 31, 2007. The Corporation is deemed to be well-capitalized under regulatory standards.

Liquidity:

Liquidity measures an organization's ability to meet cash obligations as they come due. The consolidated statements of cash flows presented in the accompanying financial statements included in Part I of this Form 10-Q provide analysis of the Corporation's cash and cash equivalents. Additionally, management considers that portion of the loan and investment portfolio that matures within one year as part of the Corporation's liquid assets.

The ALCO addresses the liquidity needs of the Bank to see that sufficient funds are available to meet credit demands and deposit withdrawals, as well as to the placement of available funds in the investment portfolio. In assessing liquidity requirements, equal consideration is given to the current position as well as the future outlook.

Off Balance Sheet Arrangements:

The Company's consolidated financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist primarily of commitments to grant new loans, unfunded commitments of existing loans and letters of credit made under the same standards as on-balance sheet instruments. Unused commitments on March 31, 2007 totaled $38.657 million, which consisted of $26.829 million in unfunded commitments of existing loans, $8.692 million to grant new loans and $3.136 million in letters of credit. Due to fixed maturity dates and specified conditions within these instruments, many will expire without being drawn upon. Management believes that amounts actually drawn upon can be funded in the normal course of operations and therefore, do not represent a significant liquidity risk to the Company.

Interest Rate Sensitivity:

The management of interest rate sensitivity seeks to avoid fluctuating net interest margins and to provide consistent net interest income through periods of changing interest rates.

The Company's risk of loss arising from adverse changes in the fair value of financial instruments, or market risk, is composed primarily of interest rate risk. The primary objective of the Company's asset/liability management activities is to maximize net interest income while maintaining acceptable levels of interest rate risk. The Company's ALCO is responsible for establishing policies to limit exposure to interest rate risk, and to ensure procedures are established to monitor compliance with those policies. The guidelines established by ALCO are reviewed by the Company's Board of Directors.

The tools used to monitor sensitivity are the Statement of Interest Sensitivity Gap and the interest rate shock analysis. The Bank uses a software model to measure and to keep track. In addition, an outside source does a quarterly analysis to make sure our internal analysis is current and correct. The Statement of Interest Sensitivity Gap is a good assessment of current position and is a very useful tool for the ALCO in performing its job. This report is monitored in an effort to "match" maturities or repricing opportunities of assets and liabilities, in order to attain the maximum interest within risk tolerance policy guidelines. The statement does, although, have inherent limitations in that certain assets and liabilities may react to changes in interest rates in different ways, with some categories reacting in advance of changes and some lagging behind the changes. In addition, there are estimates used in determining the actual propensity to change of certain items such as deposits without maturities.

The following table sets forth the Company's interest sensitivity analysis as of March 31, 2007:

INTEREST RATE SENSITIVITY ANALYSIS

(Dollars in thousands)	Maturity or Repricing In:				
	3 Months	**3-6 Months**	**6-12 Months**	**1-5 Years**	**Over 5 Years**
RATE SENSITIVE ASSETS					
Loans	$ 66,497	$ 7,961	$ 16,612	$ 106,068	$ 74,870
Securities	3,805	1,684	3,078	37,810	53,230
Interest bearing deposits in other banks	104	0	0	0	0
Federal funds sold	6,240	0	0	0	0
Total rate sensitive assets	76,646	9,645	19,690	143,878	128,100
Cumulative rate sensitive assets	$ 76,646	$ 86,187	$ 105,877	$ 249,755	$ 377,855
RATE SENSITIVE LIABILITIES					
Interest bearing checking	$ 207	$ 207	$ 415	$ 3,316	$ 18,167
Money market deposits	315	315	630	5,041	27,619
Regular savings	1,526	1,021	2,042	16,338	89,517
CDs and IRAs	27,944	29,661	14,062	26,436	3,905
Short-term borrowings	9,940	0	0	0	0
Long-term borrowings	0	0	580	4,090	27,226
Total rate sensitive liabilities	39,932	31,204	17,729	55,221	166,434
Cumulative rate sensitive liabilities	$ 39,932	$ 71,136	$ 88,865	$ 144,086	$ 310,520
Period gap	$ 36,714	$ (21,559)	$ 1,961	$ 88,657	$ (38,334)
Cumulative gap	$ 36,714	$ 15,155	$ 17,116	$ 105,773	$ 67,439
Cumulative RSA to RSL	191.94%	121.30%	119.26%	173.41%	121.72%
Cumulative gap to total assets	9.05%	3.74%	4.22%	26.08%	16.63%

RESULTS OF OPERATIONS

Net Interest Income: