

UNITED STATES
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, 2006

or

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

Commission File No. 0-28364

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)

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

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

Title of Each Class	Name of Each Exchange on which Registered
----- Common Stock \$.10 par value	----- The Nasdaq Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. [] YES [X] NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. [] YES [X] NO

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 [] Accelerated filer [] Non-accelerated filer [X]

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

As of March 14, 2007, there were 2,792,151 shares outstanding of the registrant's Common Stock.

The Registrant's voting stock trades on the NASDAQ Global 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 June 30, 2006, \$31.46 per share, was \$70,727,743 based on 2,248,180 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders for the Fiscal Year ended December 31, 2006. (Parts I, II, and IV)
2. Portions of the Proxy Statement for the 2007 Annual Meeting of Stockholders. (Part III)

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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 as detailed in Item 1A include:

- o our ability to effectively manage future growth
- o loan losses in excess of our allowance
- o risks inherent in commercial lending
- o real estate collateral which is subject to declines in value
- o regional economic factors
- o loss of senior officers
- o comparatively low legal lending limits
- o limited market for the Company's stock
- o restrictions on ability to pay dividends
- o common stock may lose value
- o competitive environment
- o issuing additional shares may dilute ownership
- o extensive and complex governmental regulation and associated cost
- o interest rate risks

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

ITEM 1. BUSINESS
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GENERAL

Norwood Financial Corp. (the "Company"), a Pennsylvania corporation, is the holding company for Wayne Bank. On March 29, 1996, the Bank completed a holding company reorganization and became a wholly owned subsidiary of the Company. As of December 31, 2006, the Company had total assets of \$454.4 million, deposits of \$358.1 million, and stockholders' equity of \$52.2 million. The Company's ratio of average equity to average assets was 11.23%, 11.19% and 11.15% for fiscal years, 2006, 2005 and 2004, respectively

Wayne Bank is a Pennsylvania chartered commercial bank headquartered 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 to applicable limits by the Deposit Insurance Fund ("DIF") 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 bank with six offices in Wayne County, three offices in Pike County and three offices in Monroe County. The Bank offers a wide variety of personal and business credit services and trust and investment products and real estate settlement services 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 twelve automated teller machines, one in each of its branch locations. The Company's main office is located at 717 Main Street, Honesdale, Pennsylvania and its telephone number is (570) 253-1455. The Bank maintains a website at www.waynebank.com.

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. Based on data compiled by the FDIC as of June 30, 2006 (the latest date for which data is available), the Bank had the third largest share of FDIC-insured deposits in Wayne County with approximately 20.5%, second in Pike County with 18.5%, and 12th in Monroe County with 1.3%. This data does not reflect deposits held by credit unions with which the Bank also competes. 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, 2006, the Bank had 117 full-time and 5 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 second home dwellings. The products include adjustable rate mortgages with terms up to 30 years which are retained and serviced through the Bank, 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 the extent consistent with our asset/liability management strategies. 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 to a lesser extent also offers indirect dealer financing of automobiles (new and used), boats, and recreational vehicles through a limited network of 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 payment 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. Such loans may entail additional credit risks compared to owner-occupied residential mortgage lending. As a result, the Bank has de-emphasized the indirect lending product line.

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. The Bank offsets such factors with requiring more owner equity, a lower loan to value ratio and by obtaining the personal guaranties of the principals. In addition, a majority of the Bank's commercial real estate portfolio is owner occupied property.

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.

There are additional risks associated with indirect automobile lending since we must rely on the automobile dealer to provide accurate information to us and accurate disclosures to the borrowers. These loans are principally done on a non-recourse basis. We seek to mitigate these risks by only dealing with dealers with whom we have a long-standing relationship.

LOAN SOLICITATION AND PROCESSING

The Bank has established various lending limits for its officers and also maintains an Officer Loan Committee to approve higher loan amounts. The loan committee is comprised of the President and Chief Executive Officer, Senior Lending Officer and other Bank officers. The Loan Committee has the authority to approve all loans up to set limits based on the type of loan and the collateral. Requests in excess of these limits must be submitted to the Directors' Loan Committee or Board of Directors for approval. Additionally, the President and Chief Executive Officer, and the Senior Lending Officer and other officers have the authority to approve secured and unsecured loans up to amounts approved by the Board of Directors and maintained in the Bank's Loan Policy. Notwithstanding individual lending authority, certain loan policy exceptions must be submitted to the loan committee for approval.

Hazard insurance coverage is required on all properties securing loans made by the Bank. Flood insurance is also required, when applicable.

Loan applicants are notified of the credit decision by letter. If the loan is approved, the loan commitment specifies the terms and conditions of the proposed loan including the amount, interest rate, amortization term, a brief description of the required collateral, and the required insurance coverage. The borrower must provide proof of fire, flood (if applicable) and casualty insurance on the property serving as collateral and title insurance, and these applicable insurances must be maintained during the full term of the loan.

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,										
2006		2005		2004		2003		2002		
\$	%	\$	%	\$	%	\$	%	\$	%	
(dollars in thousands)										
Type of Loans:										
Commercial, Financial and Agricultural..	\$ 34,019	10.8	\$ 26,755	9.2	\$ 20,263	7.9	\$ 17,022	7.3	\$ 15,074	6.9
Real Estate-Construction.....	7,714	2.4	5,944	2.0	4,890	1.9	5,904	2.5	4,109	1.9
Real Estate-Mortgage										
Residential.....	113,783	36.0	100,705	34.6	90,606	35.5	77,459	33.1	69,040	31.6
Commercial.....	138,881	44.0	133,495	45.8	111,164	43.6	96,276	41.1	79,623	36.5
Lease financing, net of unearned income.	-	-	-	-	-	-	316	.1	1,592	.7
Consumer Loans to Individuals.....	21,520	6.8	24,353	8.4	28,193	11.1	37,219	15.9	48,951	22.4
	315,917	100.0	291,252	100.0	255,116	100.0	234,196	100.0	218,389	100.0
	=====		=====		=====		=====		=====	
Unearned income and deferred fees.....	(350)		(362)		(359)		(463)		(419)	
Allowance for loan losses.....	(3,828)		(3,669)		(3,448)		(3,267)		(3,146)	
	\$311,739		\$287,221		\$251,309		\$230,466		\$214,824	
	=====		=====		=====		=====		=====	

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, 2006. 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 -----
	(in thousands)			
Commercial, Financial and Agricultural	\$12,329	\$10,551	\$11,139	\$34,019
Real Estate - Construction	7,714	--	--	7,714
	-----	-----	-----	-----
Total	\$20,043 =====	\$10,551 =====	\$11,139 =====	\$41,733 =====
Loans with fixed-rates	\$ 4,260	\$ 6,177	\$ 5,869	\$16,306
Loans with floating rates	15,783	4,374	5,270	25,427
	-----	-----	-----	-----
Total	\$20,043 =====	\$10,551 =====	\$11,139 =====	\$41,733 =====

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. The Bank did not have any loans accounted for as troubled debt restructurings at the dates indicated. For the year ended December 31, 2006, interest income that would have been recorded on loans accounted for on a non-accrual basis under the original terms of such loans was \$37,000 of which \$8,000 was collected.

	As of December 31,				
	2006	2005	2004	2003	2002
	(dollars in thousands)				
Non-accrual loans:					
Commercial and all other.....	\$ --	\$ --	\$ --	\$ --	\$ --
Real estate.....	392	330	32	125	213
Consumer.....	17	11	8	--	3
Total.....	409	341	40	125	216
Accruing loans which are contractually past-due 90 days or more:					
Commercial and all other.....	--	--	--	--	--
Real estate.....	--	--	5	--	--
Consumer.....	--	12	22	18	5
Total.....	--	12	27	18	5
Total non-performing loans.....	409	353	67	143	221
Foreclosed real estate.....	--	--	--	--	21
Total non-performing assets.....	\$409	\$353	\$ 67	\$143	\$242
Total non-performing loans to total loans....	.13%	.12%	.03%	.06%	.10%
Total non-performing loans to total assets.....	.09%	.08%	.02%	.04%	.06%
Total non-performing assets to total assets.....	.09%	.08%	.02%	.04%	.07%

The recorded investment in impaired loans, not requiring an allowance for loan losses was \$290,000 and \$310,000 at December 31, 2006 and 2005, respectively. The recorded investment in impaired loans requiring an allowance for loan losses was \$-0- at December 31, 2006 and 2005. The related allowance for loan losses associated with these loans was \$-0- at December 31, 2006 and 2005. For the years ended December 31, 2006, 2005 and 2004, the average recorded investment in these impaired loans was \$286,000, \$316,000 and \$-0- and the interest income recognized on these impaired loans was \$1,000, \$11,000 and \$-0-, respectively.

POTENTIAL PROBLEM LOANS. As of December 31, 2006, 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:

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(dollars in thousands)				
Total loans receivable net of unearned income	\$ 315,567	\$ 290,890	\$ 254,757	\$ 233,733	\$ 217,970
Average loans receivable	301,533	274,053	245,783	225,680	213,814
Allowance balance at beginning of period	\$ 3,669	\$ 3,448	\$ 3,267	\$ 3,146	\$ 3,216
Charge-offs:					
Commercial and all other	--	(4)	(19)	(121)	(34)
Real Estate	--	(6)	(10)	--	(122)
Consumer	(150)	(200)	(342)	(478)	(608)
Leases	--	--	(11)	(36)	(30)
Total	(150)	(210)	(382)	(635)	(794)
Recoveries:					
Commercial and all other	18	12	13	5	--
Real Estate	2	18	8	24	13
Consumer	65	46	78	64	72
Leases	4	5	9	3	9
Total	89	81	108	96	94
Net Charge-offs	(61)	(129)	(274)	(539)	(700)
Provision Expense	220	350	455	660	630
Allowance balance at end of period	\$ 3,828	\$ 3,669	\$ 3,448	\$ 3,267	\$ 3,146
Allowance for loan losses as a percent of total loans outstanding	1.21%	1.26%	1.35%	1.40%	1.44%
Net loans charged off loans percent of average outstanding02%	.05%	.11%	.24%	.33%

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. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which credit losses may occur. The total allowance is available to absorb losses from any type of loan.

As of December 31,

	2006		2005		2004	
	(Dollars in thousands)					
	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans
Commercial, financial and agricultural	\$ 505	10.8%	\$ 427	9.2%	\$ 337	7.9%
Real estate - construction	44	2.4	36	2.0	20	1.9
Real estate - mortgage	2,667	80.0	2,713	80.4	2,480	79.1
Consumer loans to individuals	388	6.8	442	8.4	483	11.1
Lease Financing	--	--	--	--	--	--
General Risk Allocation	224	--	51	--	128	--
Total	\$3,828	100.0%	\$3,669	100.0%	\$3,448	100.0%

As of December 31,

	2003		2002	
	(Dollars in thousands)			
	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans
Commercial, financial and agricultural	\$ 291	7.3%	\$ 265	6.9%
Real estate - construction	27	2.5	21	1.9
Real estate - mortgage	2,222	74.2	1,926	68.1
Consumer loans to individuals	634	15.9	788	22.4
Lease Financing	9	.1	24	.7
General Risk Allocation	84	--	122	--
Total	\$3,267	100.0%	\$3,146	100.0%

INVESTMENT ACTIVITIES

GENERAL. The Company maintains a portfolio of investment securities consisting principally of obligations of the U.S. Government and its agencies including mortgage-backed securities and obligations of states, counties and municipalities including school districts. To a lesser extent, the Company also has corporate debt obligations in the portfolio as well as a portfolio of equity instruments of other financial services companies. 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,		
	2006	2005	2004
Securities: (carrying value)			
U.S. Treasury Securities.....	\$ --	\$ 1,989	\$ 2,014
U.S. Government Agencies.....	47,581	51,996	47,151
State and political Subdivisions.....	17,419	21,175	24,256
Corporate Obligations.....	8,439	10,450	15,308
Mortgage-backed securities.....	38,652	29,954	32,060
Equity Securities.....	1,775	1,702	1,868
Total Securities	\$113,866	\$117,266	\$122,657
Fair value of Securities.....	\$113,883	\$117,294	\$122,811

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 as of December 31, 2006. 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 the mortgage-backed securities is based upon contractual terms, the average life may differ as a result of changes in cash flow. 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 ten years		Total Investment Securities	
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield
U.S. Government Agencies	\$25,361	2.95%	\$20,224	4.56%	\$ 1,996	5.65%	\$ --	--	\$47,581	3.75%
State and political subdivisions	991	3.23%	6,452	3.84%	7,341	6.27%	2,635	6.22%	27,419	5.47%
Corporate Obligations	5,483	2.84%	2,956	4.21%	--	--	--	--	8,439	3.32%
Mortgage-backed securities	--	--	9,380	3.93%	6,192	5.32%	23,080	4.87%	38,652	4.71%
Equity Securities	1,775	3.14%	--	--	--	--	--	--	1,775	3.14%
Total Investment Securities	\$33,610	2.95%	\$39,012	4.26%	\$15,529	5.81%	\$25,715	5.01%	\$113,866	4.30%

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 its customers on a limited basis include cash management, direct deposit and Automated Clearing House (ACH) activity. The Bank operates twelve automated teller machines and is affiliated with the STAR ATM network. Internet banking including bill-pay is offered through the website at www.waynebank.com.

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

(dollars in thousands)	2006		2005		2004	
	Average		Average		Average	
	Balance	Rate Paid	Balance	Rate Paid	Balance	Rate Paid
Non-interest bearing						
demand	\$ 54,798	--%	\$ 52,109	--%	\$ 47,399	--%
Interest-bearing demand	39,472	.10%	44,026	.10%	42,385	.10%
Money Market	57,410	2.87%	49,721	1.86%	47,466	1.07%
Savings	49,937	.46%	57,128	.47%	58,243	.47%
Time	146,344	3.96%	128,704	2.82%	118,512	2.31%
Total	\$347,961		\$331,688		\$314,005	

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, 2006.

(dollars in thousands)

Maturity Period

Within three months.....	\$28,040
Over three through six months.....	15,770
Over six through twelve months.....	7,520
Over twelve months.....	5,406

	\$56,736
	=====

SHORT-TERM BORROWINGS

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

(dollars in thousands)

	Years ended December 31,		
	2006	2005	2004
Short term borrowings:			
Average balance during the year	\$22,209	\$15,059	\$12,965
Maximum month-end balance during the year	29,677	24,956	22,982
Average interest rate during the year	4.39%	2.76%	1.17%
Total short-term borrowings at end of the year	\$22,736	\$18,564	\$22,982
Weighted average interest rate at the end of the year	4.20%	3.76%	1.83%

TRUST ACTIVITIES

The Bank operates a Wealth Management/Trust Department which provides estate planning, investment management and financial planning to customers for which it is generally compensated based on a percentage of assets under management. As of December 31, 2006, the Bank had \$96.9 million of assets under management compared to \$87.0 million as of December 31, 2005.

SUBSIDIARY ACTIVITIES

The Bank, a Pennsylvania chartered bank, is the only wholly owned subsidiary of the Company. Norwood Investment Corp. (NIC), a Pennsylvania Corporation 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 Invest Financial a registered broker/dealer. NIC had sales volume of \$10.1 million in 2006, generating gross revenues for the Company of \$131,000, compared to \$150,000 in 2005 included in Other Income.

WCB Realty Corp., a Pennsylvania Corporation, is a wholly-owned real estate subsidiary of the Bank whose principal asset is the administrative offices of the Company, which also includes the Main Office of the Bank.

WTR0 Properties Inc., a Pennsylvania Corporation, is a wholly-owned real estate subsidiary of the Bank established to hold title to certain real estate upon which the Bank has foreclosed. WTR0 did not hold title to any property as of December 31, 2006 and 2005.

Norwood Settlement Services, LLC, a Pennsylvania Limited Liability Company, was established in 2004 to provide title and settlement service to bank customers and non-customers. The subsidiary is 70% owned by Wayne Bank and 30% owned by Title Strategies, LLC. Gross revenues, included in other income, for 2006 totaled \$37,000 and \$26,000 in 2005.

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

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.

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 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 and 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 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 previously administered two separate insurance funds, the Bank Insurance Fund (BIF), which generally insured commercial bank and state savings bank deposits, and the Savings Insurance Fund ("SAIF"), which generally insured savings association deposits.

Under the Federal Deposit Insurance Reform Act of 2005 (The "Reform Act"), which was signed into law on February 15, 2006 (i) the Bank Insurance Fund and the Savings Association Insurance Fund were merged into a new combined fund, called the Deposit Insurance Fund effective March 31, 2006, (ii) the current \$100,000 deposit insurance coverage will be indexed for inflation (with adjustments every five years, commencing January 1, 2011); and (iii) deposit insurance coverage for retirement accounts were increased to \$250,000 per participant subject to adjustment for inflation. The FDIC has been given greater latitude in setting the assessment rates for insured depository institutions which could be used to impose minimum assessments.

The FDIC is authorized to set the reserve ratios for the Deposit Insurance Fund annually at between 1.15% and 1.5% of estimated insured deposits. If the Deposit Insurance Fund's reserves exceed the designated reserve ratio, the FDIC is required to pay out all or, if the reserve ratio is less than 1.5%, a portion of the excess as a dividend to insured depository institutions based on the percentage of insured deposits held on December 31, 1996 adjusted for subsequently paid premiums. Insured depository institutions that were in existence on December 31, 1996 and paid assessments prior to that date (or their successors) are entitled to a one-time credit against future assessments based on their past contributions to the BIF or SAIF.

Pursuant to the Reform Act, the FDIC has determined to maintain the designated reserve ratio at its current 1.25%. The FDIC has also adopted a new risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. Beginning in 2007, well-capitalized institutions with the CAMELS ratings of 1 or 2 will be grouped in Risk Category I and will be assessed for deposit insurance at an annual rate of between five and seven basis points with the assessment rate for an individual institution to be determined according to a formula based on a weighted average of the institution's individual CAMEL component ratings plus either five financial ratios or the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV will be assessed at annual rates of 10, 28 and 43 basis points, respectively. The Bank anticipates that it will be able to offset its deposit insurance premium for 2007 with the special assessment credit.

In addition, all insured institutions of the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, an agency of the Federal government established to finance resolutions of insolvent thrifts. These assessments, the current quarterly rate of which is approximately .0154 of insured deposits, 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, 2006, 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 servicing and purchased credit card relationships, and minus certain other listed assets.

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 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, 2006.

AFFILIATE TRANSACTION RESTRICTIONS. Federal laws strictly limit the ability of banks to engage in transactions with their affiliates, including their bank holding companies. In particular loans by 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 other 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.

LOANS TO ONE BORROWER. Under Pennsylvania law, commercial banks have, subject to certain exemptions, lending limits to one borrower in an amount equal to 15% of the institution's capital accounts. An institution's capital account includes the aggregate of all capital, surplus, undivided profits, capital securities and general reserves for loan losses. Pursuant to the national bank parity provisions of the Pennsylvania Banking Code, the Bank may also lend up to the maximum amounts permissible for national banks, which are allowed to

make loans to one borrower of up to 25% of capital and surplus in certain circumstances. As of December 31, 2006, loans-to-one-borrower limitation was \$8.2 million and the Bank was in compliance with such limitation.

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.

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, 2006, 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 requirements imposed by the Federal Reserve may be used to satisfy the liquidity requirements that are imposed by the Department. At December 31, 2006, 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 1A. RISK FACTORS
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In determining whether to invest in our securities, investors should consider, among other factors, the following:

RISKS RELATED TO OUR BUSINESS

OUR SUCCESS WILL DEPEND UPON OUR ABILITY TO EFFECTIVELY MANAGE OUR FUTURE GROWTH.

We believe that we have in place the management and systems, including data processing systems, internal controls and a strong credit culture, to support continued growth. However, our continued growth and profitability depend on the ability of our officers and key employees to manage such growth effectively, to attract and retain skilled employees and to maintain adequate internal controls and a strong credit culture. Accordingly, there can be no assurance that we will be successful in managing our expansion, and the failure to do so would adversely affect our financial condition and results of operations.

IF WE EXPERIENCE LOAN LOSSES IN EXCESS OF OUR ALLOWANCE, OUR EARNINGS WILL BE ADVERSELY AFFECTED.

The risk of credit losses on loans varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the value and marketability of the collateral for the loan. Management maintains an allowance for loan losses based upon, among other things, historical experience, an evaluation of economic conditions and regular reviews of delinquencies and loan portfolio quality. Based upon such factors, management makes various assumptions and judgments about the ultimate collectibility of the loan portfolio and provides an allowance for loan losses based upon a percentage of the outstanding balances and for specific loans when their ultimate collectibility is considered questionable. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb future losses, or if the bank regulatory authorities require us to increase the allowance for loan losses as a part of their examination process, our earnings and capital could be significantly and adversely affected.

As of December 31, 2006, our allowance for loan losses was \$3,828,000 which represented 1.21% of outstanding loans. At such date, we had 10 nonperforming loans totaling \$409,000. We actively manage our nonperforming loans in an effort to minimize credit losses. Although management believes that its allowance for loan losses is adequate, there can be no assurance that the allowance will prove sufficient to cover future loan losses. Further, although management uses the best information available to make determinations with respect to the allowance for loan losses, future adjustments may be necessary if economic conditions differ substantially from the assumptions used or adverse developments arise with respect to our non-performing or performing loans. Material additions to our allowance for loan losses would result in a decrease in our net income and capital, and could have a material adverse effect on our financial condition and results of operations.

MOST OF OUR LOANS ARE TO COMMERCIAL BORROWERS, WHICH HAVE A HIGHER DEGREE OF RISK THAN OTHER TYPES OF LOANS.

Commercial loans are often larger and may involve greater risks than other types of lending. Because payments on such loans are often dependent on the successful operation of the property or business involved, repayment of such loans may be more sensitive than other types of loans to adverse conditions in the real estate market or the economy. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may be substantially dependent on the success of the business itself and

the general economic environment. If the cash flow from business operations is reduced, the borrower's ability to repay the loan may be impaired.

MOST OF OUR LOANS ARE SECURED, IN WHOLE OR IN PART, WITH REAL ESTATE COLLATERAL WHICH IS SUBJECT TO DECLINES IN VALUE.

In addition to the financial strength and cash flow characteristics of the borrower in each case, we often secure our loans with real estate collateral. As of December 31, 2006, approximately 82% of our loans, had real estate as a primary, secondary or tertiary component of collateral. Real estate values and real estate markets are generally affected by, among other things, changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies, and acts of nature. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower. If real estate prices in our markets decline, the value of the real estate collateral securing our loans could be reduced. If we are required to liquidate the collateral securing a loan during a period of reduced real estate values to satisfy the debt, our earnings and capital could be adversely affected.

OUR BUSINESS IS GEOGRAPHICALLY CONCENTRATED AND IS SUBJECT TO REGIONAL ECONOMIC FACTORS THAT COULD HAVE AN ADVERSE IMPACT ON OUR BUSINESS.

Substantially all of our business is with customers in our market area of Northeastern Pennsylvania. Most of our customers are consumers and small and medium-sized businesses which are dependent upon the regional economy. Adverse changes in economic and business conditions in our markets could adversely affect our borrowers, their ability to repay their loans and to borrow additional funds, and consequently our financial condition and performance.

Additionally, we often secure our loans with real estate collateral, most of which is located in Northeastern Pennsylvania. A decline in local economic conditions could adversely affect the values of such real estate. Consequently, a decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are geographically diverse.

THE LOSS OF SENIOR EXECUTIVE OFFICERS AND CERTAIN OTHER KEY PERSONNEL COULD HURT OUR BUSINESS.

Our success depends, to a great extent, upon the services of William W. Davis, Jr., our President and Chief Executive Officer, and Lewis J. Critelli, our Executive Vice President and Chief Financial Officer. Although we have employment agreements with non-compete provisions with Messrs. Davis and Critelli, the existence of such agreements does not assure that we will retain their services. The unexpected loss of these individuals could have a material adverse effect on our operations. From time to time, we also need to recruit personnel to fill vacant positions for experienced lending officers and branch managers. Competition for qualified personnel in the banking industry is intense, and there can be no assurance that we will continue to be successful in attracting, recruiting and retaining the necessary skilled managerial, marketing and technical personnel for the successful operation of our existing lending, operations, accounting and administrative functions or to support the expansion of the functions necessary for our future growth. Our inability to hire or retain key personnel could have a material adverse effect on our results of operations.

OUR LEGAL LENDING LIMITS ARE RELATIVELY LOW AND RESTRICT OUR ABILITY TO COMPETE FOR LARGER CUSTOMERS.

At December 31, 2006, our lending limit per borrower was approximately \$8.2 million, or approximately 15% of our capital plus allowance for loan losses. Accordingly, the size of loans that we can offer to potential borrowers is less than the size of loans that many of our competitors with larger capitalization are able to offer. We may engage in loan participations with other banks for loans in excess of our legal lending limits. However, there can be no assurance that such participations will be available at all or on terms which are favorable to us and our customers.

RISKS RELATED TO OUR COMMON STOCK

THERE IS A LIMITED TRADING MARKET FOR OUR COMMON STOCK, WHICH MAY ADVERSELY IMPACT YOUR ABILITY TO SELL YOUR SHARES AND THE PRICE YOU RECEIVE FOR YOUR SHARES.

Although our common stock is quoted on the Nasdaq Global Market, there has been limited trading activity in our stock and an active trading market is not expected to develop. This means that there may be limited liquidity for our common stock, which may make it difficult to buy or sell our common stock, may negatively affect the price of our common stock and may cause volatility in the price of our common stock.

THERE ARE RESTRICTIONS ON OUR ABILITY TO PAY CASH DIVIDENDS.

Although we have paid cash dividends on a quarterly basis since 1996, and the Bank has paid dividends for many previous years, there is no assurance that we will continue to pay cash dividends. Future payment of cash dividends, if any, will be at the discretion of the Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements and such other factors as the Board may deem relevant and will be subject to applicable federal and state laws that impose restrictions on our ability to pay dividends.

OUR COMMON STOCK IS NOT INSURED AND YOU COULD LOSE THE VALUE OF YOUR ENTIRE INVESTMENT.

An investment in shares of our common stock is not a deposit and is not insured against loss by the government.

OUR MANAGEMENT AND SIGNIFICANT SHAREHOLDERS CONTROL A SUBSTANTIAL PERCENTAGE OF OUR STOCK AND THEREFORE HAVE THE ABILITY TO EXERCISE SUBSTANTIAL CONTROL OVER OUR AFFAIRS.

As of December 31, 2006, our directors and executive officers beneficially owned approximately 374,733 shares, or approximately 12.8 % of our common stock, including options to purchase 125,187 shares, in the aggregate, of our common stock at exercise prices ranging from \$10.36 to \$31.50 per share. Because of the large percentage of stock held by our directors and executive officers and other significant shareholders, these persons could influence the outcome of any matter submitted to a vote of our shareholders.

WE MAY ISSUE ADDITIONAL SHARES OF COMMON OR PREFERRED STOCK, WHICH MAY DILUTE THE OWNERSHIP AND VOTING POWER OF OUR SHAREHOLDERS AND THE BOOK VALUE OF OUR COMMON STOCK.

We are currently authorized to issue up to 10,000,000 shares of common stock of which 2,797,151 shares are currently outstanding and up to 5,000,000 shares of preferred stock of which no shares are outstanding. Our Board of Directors has authority, without action or vote of the shareholders, to issue all or part of the authorized but unissued shares and to establish the terms of any series of preferred stock. These authorized but unissued

shares could be issued on terms or in circumstances that could dilute the interests of other stockholders. In addition, a total of 250,000 shares of common stock have been reserved for issuance under the Norwood Financial Corp 2006 Stock Option Plan, of which 47,700 were issued as of December 31, 2006. As of December 31, 2006, options to purchase a total of 135,945 shares were exercisable and had exercise prices ranging from \$10.36 to \$31.50. Any such issuance will dilute the percentage ownership interest of shareholders and may further dilute the book value of our common stock.

PROVISIONS OF OUR ARTICLES OF INCORPORATION AND THE PENNSYLVANIA BUSINESS CORPORATION LAW COULD DETER TAKEOVERS WHICH ARE OPPOSED BY THE BOARD OF DIRECTORS.

Our articles of incorporation require the approval of 80% of our outstanding shares for any merger or consolidation unless the transaction meets certain fair price criteria or the business combination has been approved or authorized by the Board of Directors. In addition, our articles of incorporation may require the disgorgement of profits realized by any person who attempts to acquire control of the Company. As a Pennsylvania corporation with a class of securities registered with the Securities and Exchange Commission, the Company is governed by certain provisions of the Pennsylvania Business Corporation Law that, inter alia, permit the disparate treatment of certain shareholders; prohibit calls of special meetings of shareholders; require unanimous written consent for shareholder action in lieu of a meeting; require shareholder approval for certain transactions in which a shareholder has an interest; and impose additional requirements on business combinations with persons who are the beneficial owners of more than 20% of the Company's stock.

RISKS RELATED TO OUR INDUSTRY

WE OPERATE IN A COMPETITIVE MARKET WHICH COULD CONSTRAIN OUR FUTURE GROWTH AND PROFITABILITY.

We operate in a competitive environment, competing for deposits and loans with commercial banks, savings associations and other financial entities. Competition for deposits comes primarily from other commercial banks, savings associations, credit unions, money market and mutual funds and other investment alternatives. Competition for loans comes primarily from other commercial banks, savings associations, mortgage banking firms, credit unions and other financial intermediaries. Many of the financial intermediaries operating in our market area offer certain services, such as international banking services, which we do not offer. Moreover, banks with a larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the needs of larger customers.

WE ARE REQUIRED TO COMPLY WITH EXTENSIVE AND COMPLEX GOVERNMENTAL REGULATION WHICH CAN ADVERSELY AFFECT OUR BUSINESS.

Our operations are and will be affected by current and future legislation and by the policies established from time to time by various federal and state regulatory authorities. We are subject to supervision and periodic examination by the Federal Reserve Board (the "FRB"), the Federal Deposit Insurance Corporation (the "FDIC") and the Pennsylvania Department of Banking. Banking regulations, designed primarily for the safety of depositors, may limit a financial institution's growth and the return to its investors by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, investments, loans and interest rates, interest rates paid on deposits, expansion of branch offices, and the offering of securities or trust services. We are also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that we are found by regulatory examiners to be undercapitalized. It is not possible to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that any such

changes may have on our future business and earnings prospects. Further, the cost of compliance with regulatory requirements may adversely affect our ability to operate profitably.

In addition, the monetary policies of the FRB have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future. Among the instruments of monetary policy used by the FRB to implement its objectives are changes in the discount rate charged on bank borrowings and changes in the reserve requirements on bank deposits. It is not possible to predict what changes, if any, will be made to the monetary policies of the FRB or to existing federal and state legislation or the effect that such change may have on our future business and earnings prospects.

During the past several years, significant legislative attention has been focused on the regulation and deregulation of the financial services industry. Non-bank financial institutions, such as securities brokerage firms, insurance companies and money market funds, have been permitted to engage in activities which compete directly with traditional bank business.

WE REALIZE INCOME PRIMARILY FROM THE DIFFERENCE BETWEEN INTEREST EARNED ON LOANS AND INVESTMENTS AND INTEREST PAID ON DEPOSITS AND BORROWINGS, AND CHANGES IN INTEREST RATES MAY ADVERSELY AFFECT OUR PROFITABILITY AND ASSETS.

Changes in prevailing interest rates may hurt our business. We derive our income mainly from the difference or "spread" between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. In general, the larger the spread, the more we earn. When market rates of interest change, the interest we receive on our assets and the interest we pay on our liabilities will fluctuate. This can cause decreases in our spread and can adversely affect our income.

Interest rates affect how much money we can lend. For example, when interest rates rise, the cost of borrowing increases and loan originations tend to decrease. In addition, changes in interest rates can affect the average life of loans and investment securities. A reduction in interest rates generally results in increased prepayments of loans and mortgage-backed securities, as borrowers refinance their debt in order to reduce their borrowing cost. This causes reinvestment risk, because we generally are not able to reinvest prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities. Changes in market interest rates could also reduce the value of our financial assets. If we are unsuccessful in managing the effects of changes in interest rates, our financial condition and results of operations could suffer.

AS A PUBLIC COMPANY, WE ARE SUBJECT TO NUMEROUS REPORTING REQUIREMENTS THAT ARE CURRENTLY EVOLVING AND COULD SUBSTANTIALLY INCREASE OUR OPERATING EXPENSES AND DIVERT MANAGEMENT'S ATTENTION FROM THE OPERATION OF OUR BUSINESS.

The Sarbanes-Oxley Act of 2002, which became law in July 2002, has required changes in some of our corporate governance, securities disclosure and compliance practices. In response to the requirements of that Act, the SEC has promulgated new rules covering a variety of subjects. Compliance with these new rules has significantly increased our legal and financial and accounting costs, and we expect these increased costs to continue. In addition, compliance with the requirements has taken a significant amount of management's and the Board of Directors' time and resources. Likewise, these developments may make it more difficult for us to attract and retain qualified members of our board of directors, particularly independent directors, or qualified executive officers.

As directed by Section 404 of the Sarbanes-Oxley Act, the SEC adopted rules requiring public companies to include a report of management on the company's internal control over financial reporting in their annual reports on Form 10-K that contains an assessment by management of the effectiveness of the company's internal control over financial reporting beginning with the annual report on Form 10-K for our fiscal year ending December 31, 2007. In addition, in the future, the public accounting firm auditing the company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal control over financial reporting. This requirement is first applicable to our annual report on Form 10-K for fiscal 2008 and for all future annual reports. The costs associated with the implementation of this requirement, including documentation and testing, have not been estimated by us. If we are ever unable to conclude that we have effective internal control over financial reporting or, if our independent auditors are unable to provide us with an unqualified report as to the effectiveness of our internal control over financial reporting for any future year-ends as required by Section 404, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our securities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

The Bank operates from its main office located at 717 Main Street, Honesdale, Pennsylvania and eleven additional branch offices. The Bank's total investment in office property and equipment is \$13.3 million with a net book value of \$6.0 million as of December 31, 2006. The Bank currently operates automated teller machines at all twelve of its facilities. The Bank leases four of its locations with minimum lease commitments of \$4,011,000 through 2029. The four locations have various renewal options.

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 REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND

ISSUER PURCHASES OF EQUITY SECURITIES

Information relating to the market for Registrant's common equity and related stockholder matters appears under "Capital and Dividends" in the Registrant's Annual Report to Stockholders for the fiscal year ended December 31, 2006 ("Annual Report") and is incorporated herein by reference.

Issuer Purchases of Equity Securities

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs*	Maximum number of shares (or approximate dollar value) that may yet be purchased under the plans or programs
October 1-October 31, 2006	5,000	\$31.10	5,000	94,863
November 1-November 30, 2006	--	--	--	--
December 1-December 31, 2006	2,000	31.25	2,000	92,863
Total	7,000	\$31.14	7,000	92,863

* On June 15, 2005, the Registrant announced its intention to repurchase up to 5% of its outstanding common stock (approximately 134,000 shares) in the open market.

ITEM 6. SELECTED FINANCIAL DATA

The above-captioned information appears under "Summary of Selected Financial 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" in the Annual Report and is incorporated herein by reference from the Annual Report.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The above-captioned information appears under "Management's Discussion and Analysis -- Market Risk" 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 15 are incorporated herein by reference from the Annual Report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

The Company's management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information contained under the sections captioned "Section 16(a) Beneficial Ownership Reporting Compliance" and "Proposal I-- Election of Directors" and "Corporate Governance" in the Proxy Statement for the 2007 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated herein by reference.

The Company has adopted a Code of Ethics that applies to its principal executive officer, principal financial officer and principal accounting officer or controller. The Company undertakes to provide a copy of the Code of Ethics to any person without charge, upon request to Lewis J. Critelli Executive Vice President and Chief Financial Officer, Norwood Financial Corp., 717 Main Street, Honesdale, PA 18431.

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 AND RELATED STOCKHOLDER MATTERS

(a) Security Ownership of Certain Beneficial Owners

Information required by this item is incorporated herein by reference to the Section captioned "Principal Holders of Our Common Stock" of the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the sections captioned "Proposal I -- Election of Directors" of the Proxy Statement.

(c) Changes in Control

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.

(d) Equity Compensation Plan Information

EQUITY COMPENSATION PLAN INFORMATION

	(a)	(b)	(c)
	Number of securities To be issued upon Exercise of outstanding options, warrants and rights -----	Weighted average exercise price of outstanding options, warrants and rights -----	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) -----
Equity compensation plans approved by shareholders:			
Stock Option Plan.....	128,027	\$18.71	--
2006 Stock Option Plan.....	47,700	30.91	202,300
Equity compensation plan not approved by shareholders:			
1999 Directors Stock Compensation Plan.....	7,918 -----	17.10 -----	-- -----
TOTAL.....	183,645 =====	\$21.81 =====	202,300 =====

The 1999 Directors Stock Compensation Plan provides for annual grants of options to non-employee directors as of the close of business on the day of the first regularly scheduled board meeting in December of each year. The amounts of such awards are determined by the board or a committee thereof. The exercise price for each option is equal to the fair market value of the stock as of the date of grant. Options generally have terms of ten years and one day from the date of grant and vest over periods ranging from six months to one year from the date of grant. Except in the event of death or disability, optionees may not sell shares acquired on exercise of options within six months of the date of grant. Options are not transferable except in the event of the death of the optionee.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR

INDEPENDENCE

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

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item is incorporated herein by reference to the section on the Proxy Statement captioned "Proposal 2-Ratification of Appointment of Independent Auditors."

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT, AND SCHEDULES

(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, 2006 and 2005, 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, 2006, together with the related notes and the report of independent registered public accounting firm of Beard Miller Company LLP, independent registered public accounting firm.
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 seven key employees of the Bank***
- 10.4+ Consulting Agreement with Russell L. Ridd****
- 10.5+ Norwood Financial Corp. Stock Option Plan*****
- 10.6+ Salary Continuation Agreement between the Bank and William W. Davis, Jr.***
- 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***
- 10.10+ Salary Continuation Agreement between the Bank and Joseph A. Kneller*****
- 10.11+ Salary Continuation Agreement between the Bank and John H. Sanders*****
- 10.12+ 2006 Stock Option Plan*****
- 10.13+ First and Second Amendments to Salary Continuation Agreement with William W. Davis, Jr.*****
- 10.14+ First and Second Amendments to Salary Continuation Agreement with Lewis J. Critelli *****
- 10.15+ First and Second Amendments to Salary Continuation Agreement with Edward C. Kasper*****
- 10.16+ First and Second Amendments to Salary Continuation Agreement with Joseph A. Kneller*****
- 10.17+ First and Second Amendments to Salary Continuation Agreement with John H. Sanders*****
- 13 Annual Report to Stockholders for the fiscal year ended December 31, 2006
- 21 Subsidiaries of Norwood Financial Corp. (see Item 1. Business, General and Subsidiary Activity)
- 23 Consent of Independent Registered Public Accounting Firm
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of CEO
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of CFO
- 32 Certification pursuant to 18 U.S. C. SS.1350, as adopted pursuant to SS.906 of Sarbanes Oxley Act of 2002

-
- + Management contract or compensatory plan arrangement.
 - * 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.0-28364.
 - ** Incorporated by reference into this document from the identically numbered exhibits to the registrant's Form 8-K filed with the Commission March 6, 2006.
 - *** Incorporated herein by reference into this document from the Exhibits to the Registrant's Form 10-K filed with the Commission on March 23, 2000, File No. 0-28364.
 - **** Incorporated by reference into this document from the Exhibit to the Registrant's Form 10-K filed with the Commission on March 31, 1997, File No. 0-28364.
 - ***** Incorporated by reference into this document from the Exhibits to Form S-8 filed with the Commission on August 14, 1998, File No. 333-61487.
 - ***** Incorporated by reference into this document from the identically numbered exhibits to the Registrant's Form 10-K filed with the Commission on March 22, 2004, File No. 0-28364.
 - ***** Incorporated by reference to this document from Exhibit 4.1 to Registrant's Registration Statement on Form S-8 (File No. 333-134831) filed with the Commission on June 8, 2006.
 - ***** Incorporated herein by reference from the Exhibits to the Registrant's Current Report on Form 8-K filed April 4, 2006.

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, 2007

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, 2007 by the following persons on behalf of the Registrant and in the capacities indicated.

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

William W. Davis, Jr.
President, Chief Executive Officer
and Chief Financial Officer
and Director
(Principal Executive Officer)

By: /s/ Lewis J. Critelli

Lewis J. Critelli
Executive Vice President

(Principal Financial and Accounting
Officer)

By:

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/ Ralph A. Matergia

Ralph A. Matergia
Director

By:

Richard L. Snyder
Director

By: /s/ Susan Gumble-Cottell

Susan Gumble-Cottell
Director

[GRAPHIC OMITTED]

MAIN STREET HONESDALE, 1912

Wayne County Fair Parade proceeds down Main Street in Honesdale, 1912. Fair President W.J. Ferguson rides on the first carriage with Amos Ward, Marshall. Note the ox-drawn cart and muddy street.

A HERITAGE OF HARD WORK, DILIGENCE AND ACHIEVEMENT

[GRAPHIC OMITTED]

NORWOOD FINANCIAL CORP.

o

2006 ANNUAL REPORT

[GRAPHIC OMITTED]

MAIN STREET - CIRCA 1942

Color postcard depicting Honesdale in the 1930s-40s. Note Wayne Bank, the yellow-pillared building on the right.

SUMMARY OF SELECTED FINANCIAL DATA
(dollars in thousands, except per share data)

For the years ended December 31,	2006	2005	2004	2003	2002
Net interest income	\$ 16,183	\$ 15,263	\$ 14,012	\$ 13,322	\$ 13,951
Provision for loan losses	220	350	455	660	630
Other income	3,517	3,506	3,088	2,801	2,577
Net realized gains on sales of securities	66	42	458	692	427
Other expense	10,957	10,623	10,090	9,808	10,349
Income before income taxes	8,589	7,838	7,013	6,347	5,976
Income tax expense	2,679	2,341	2,003	1,694	1,623
Net Income	\$ 5,910	\$ 5,497	\$ 5,010	\$ 4,653	\$ 4,353
Net income per share-Basic	\$ 2.11	\$ 1.96*	\$ 1.80*	\$ 1.70*	\$ 1.62*
Net income per share-Diluted	\$ 2.07	\$ 1.92*	\$ 1.77*	\$ 1.67*	\$ 1.60*
Cash dividends declared	0.85	0.71*	0.66*	0.62*	0.57*
Dividend pay-out ratio	40.28%	36.41%	36.51%	36.31%	35.29%
Return on average assets	1.33%	1.31%	1.27%	1.22%	1.21%
Return on average equity	11.85%	11.72%	11.39%	11.24%	11.60%
BALANCES AS OF YEAR END					
Total assets	\$454,356	\$433,556	\$411,626	\$387,483	\$367,468
Loans receivable	315,567	290,890	254,757	233,733	217,970
Allowance for loan losses	3,828	3,669	3,448	3,267	3,146
Total deposits	358,103	340,603	318,645	306,669	291,852
Shareholders' equity	52,231	48,108	45,685	42,831	40,125
Trust assets under management	96,879	86,972	83,397	73,991	60,102
Book value per share	\$ 18.67	\$ 17.07*	\$ 16.14*	\$ 15.20*	\$ 14.37*
Tier 1 Capital to risk-adjusted assets	15.67%	15.29%	15.91%	15.58%	15.06%
Total Capital to risk-adjusted assets	16.99%	16.63%	17.34%	17.09%	16.57%
Allowance for loan losses to total loans	1.21%	1.26%	1.35%	1.40%	1.44%
Non-performing assets to total assets	0.09%	0.08%	0.02%	0.04%	0.07%

* References to share and per-share amounts reflect the 5% stock dividend distributed to shareholders on May 26, 2006.

NORWOOD
FINANCIAL CORP

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[GRAPHIC OMITTED]

Portrait of the Honesdale Semi-Pro Baseball Club. Note Christy Mathewson second from the left. Mathewson was one of the first five players ever elected to the Baseball Hall of Fame.

A Letter to our Shareholders

We hope you enjoy the photographs throughout this year's Annual Report, reflecting various eras in our community's history. We feel they reflect the ongoing sense of community and strong work ethic our local people have demonstrated generation after generation and into the present time. These values are important to Wayne Bank and to our community, and we are proud to offer examples from our work this year that demonstrate the Bank's dedication to building community through initiative and dedicated labor.

WE ARE PLEASED TO REPORT that your Company had a very strong financial performance in 2006. Our earnings for the year ended December 31, 2006 totaled \$5,910,000 which is an increase of \$413,000, or 7.5%, over the \$5,497,000 earned in 2005. Earnings per share on a fully diluted basis were \$2.07 compared to \$1.92 in 2005. The return on average assets for the year was 1.33% with a return on average equity of 11.85%. Both of these measures of performance improved over the prior year.

As a result of this excellent performance, the Board of Directors approved two increases to dividends declared for our shareholders during 2006. Cash dividends declared per share totaled \$.85 in 2006, an increase of \$.14 or 19.7% over the \$.71 per share declared in 2005. In addition, the Company also distributed a 5% stock dividend in May 2006.

Total assets as of December 31, 2006 were \$454.4 million with loans receivable of \$315.6 million, deposits of \$358.1 million and shareholders' equity of \$52.2 million. Total assets have increased \$20.8 million from December 31, 2005.

We had steady loan activity throughout 2006. Loans receivable increased \$24.7 million, or 8.5% from the prior year. We had balanced growth during the year with the commercial loan portfolio increased \$12.6 million and residential mortgages, including home equity financing, growing \$13.1 million. The majority of our loan growth was funded with a \$17.5 million increase in deposits.

Credit quality ratios were consistently strong during the year. Non-performing loans totaled \$409,000 and represented .13% of loans as of December 31, 2006 compared to \$353,000 and .12% as of year ended 2005. Our net charge-offs decreased by over 50%, and totaled \$61,000 in 2006

NET INCOME

(\$ in thousands) for the year ended December 31

[BAR GRAPH WITH FOLLOWING DATA POINTS:

2002 - \$4,353
2003 - \$4,653
2004 - \$5,010
2005 - \$5,497
2006 - \$5,910]

compared to \$129,000 in 2005. As a result of the lower level of charge-offs, our provision expense in 2006 was \$220,000 compared to \$350,000 in 2005. The allowance for loan losses totaled \$3,828,000 and 1.21% as of December 31, 2006 compared to \$3,669,000 and 1.26% as of year end 2005.

The Company faced a challenging interest rate environment during 2006, in which short term interest rates, which effect CD rates, were higher than long term rates, which impacts loan pricing. For the year, net interest income (fully taxable equivalent) totaled \$16,708,000, an increase of \$819,000 over the \$15,889,000 earned in 2005. Our net interest margin, (fte) for the year was 3.96% decreasing only 3 basis points from 3.99% in the prior year. The slight decrease in net interest margin was principally due to an increase in deposit costs, most evident in the CD portfolio, which was partially offset by loan volume and higher yields on loans and investments.

For the year, other income totaled \$3,583,000 compared to \$3,548,000 in 2005. The increase was principally due to \$147,000 in gains on sales of mortgage loans and servicing rights in 2006 increasing from \$64,000 in similar gains in 2005. Other expenses totaled \$10,957,000 in 2006, an increase of \$334,000 or 3.1% over the prior year. The increase was principally due to rising salary and employee benefit costs. We strongly encourage you to read Management's Discussion and Analysis and the Audited Financial Statements and Footnotes for more details on our performance.

DILUTED EARNINGS PER SHARE

For the year ended December 31

[BAR GRAPH WITH FOLLOWING DATA POINTS:

2002 - \$1.60
2003 - \$1.67
2004 - \$1.77
2005 - \$1.92
2006 - \$2.07]

Wayne Bank takes pride in seeing businesses, in particular locally owned businesses, flourish in all the communities we serve. In accord with our slogan, "Helping the Community Grow," we have helped to finance start-up businesses as well as the expansion of existing businesses. The Bank played a major role in the significant commercial growth experienced in our market area during 2006. Wayne Bank also launched a Free Business Checking account in December of 2006 and began to offer small business owners loans at the

[GRAPHIC OMMITTED]

Do Your Part - Circa 1944

The bank lobby circa 1944 - evident are the various war bond signs and the flags of our allies, along with the scale which still resides in the lobby today. Above right is our original bond wallet as issued by Wayne Bank.

branch level for those who were looking for loans of \$50,000 or less. We are able to offer "Same Day Approval" on these loans due to the fact that Wayne Bank is locally owned--many of the inconveniences that go with large financial institutions are not a dilemma with Wayne Bank. We pride ourselves on giving our customers exceptional service with quick decision-making and rapid-fire processing.

Throughout its long history, Wayne Bank has helped thousands of individuals and families enjoy the benefits of homeownership. That tradition continues into the 21st century. In 2006 we generated almost \$50 million in loans for new home construction, purchases and refurbishing. New, more flexible Residential Mortgage and Home Equity Lending Programs were also introduced to meet the needs of our communities. The Bank actively supports the local home building industry--our officers are active in area realtors' and builders' associations.

BOOK VALUE PER SHARE

as of year end December 31

[BAR GRAPH WITH FOLLOWING DATA POINTS:

2002 - \$14.37
2003 - \$15.20
2004 - \$16.14
2005 - \$17.07
2006 - \$18.67]

The Wealth Management and Trust Services Division staff believes that "slow and steady wins the race." This philosophy of controlled growth allows us to provide the level of services our clients deserve and expect. The department ended the year with a record dollar value of assets under management, increasing almost \$10 million dollars from the previous year. This resulted in a record high level of total revenue.

Many of the Bank's key business objectives are centered upon the effective deployment of information technology. Technology investments made in recent years have led to improvements in productivity that influenced the Bank's ability to control costs and stay competitive during 2006. For example, a modern wire transfer system introduced during the third quarter reduces handling by 70% while enhancing accuracy for all wires and adding cost savings for foreign interchange transactions.

Direct Link, our Internet banking service, now includes bill payment capability, expanded access to account information and the addition of Direct Protect authentication to enhance online security. New telecommunications, security and customer service devices have been introduced throughout our community office network. Our transaction processing unit continues its work to align the bank with paper reduction strategies such as the Federal Reserve's Check 21 program, converting checks to digital form for interbank exchange and archives. Great strides have been made in converting internal file systems to digitized format and providing Direct Link users with detailed transaction histories for their loans.

[GRAPHIC OMITTED]

The Norwood Financial Corp. Board of Directors (left to right) William W. Davis, Jr., Russell Ridd, Daniel J. O'Neill, John E. Marshall, Richard L. Snyder, Susan Gumble-Cottell, Dr. Kenneth A. Phillips, Ralph A. Matergia, Esq. and Gary P. Rickard, in the newly renovated lobby of the main branch in Honesdale, PA.

TOTAL DEPOSITS

(\$ in millions) as of year end December 31

[BAR GRAPH WITH FOLLOWING DATA POINTS:

2002 - \$291.9
2003 - \$306.7
2004 - \$318.6
2005 - \$340.6
2006 - \$358.1]

Wayne Bank employs over 120 people throughout Wayne, Pike and Monroe Counties. Year after year, we steadfastly achieve the results we desire due to the combined efforts of our Board of Directors, officers and employees. It is always a pleasure to recognize the achievements of our staff. In 2006 the following Wayne Bank employees were promoted to Vice President: Ray Hebden, JoAnn Fuller and Jennifer Witowic. In addition, Teresa Melucci was promoted to Branch Manager in our Stroudsburg location, Renee Gilbert was promoted to Branch Manager in our Tannersville location and Sandy Mruczkewycz was hired as Branch Manager of the Lords Valley location. Lastly, Jeff Shrader was hired and appointed to Vice President, Regional Manager of the Monroe County Branches. Notably, we had 16 staff members who have achieved between 5 and 30 years of service, a remarkable feat when so many people are transient these days.

TIMBERBERING - CIRCA 1895

[GRAPHIC OMITTED]

Men at work at Dyberry Sawmill. At left, a formal portrait of Horace C. Hand, Cashier of Wayne County Savings Bank from its inception in 1871 to January 1898, a service of 27 years. Mr. Hand was elected President of the Bank in 1898.

[GRAPHIC OMITTED]
Senior Management 2006

Senior Management at the Bank's entrance in Honesdale, PA.

Front row, from left to right are: Wayne D. Wilcha, William W. Davis, Jr., and Lewis J. Critelli. Back row, from left to right are: Edward C. Kasper, Joseph A. Kneller and John H. Sanders.

TOTAL LOANS

(\$ in millions) as of December 31

[BAR GRAPH WITH FOLLOWING DATA POINTS:

2002 - \$218.0
2003 - \$233.7
2004 - \$254.8
2005 - \$290.9
2006 - \$315.6

In 2006, we were extremely pleased to have Susan Gumble-Cottell join the Board of Directors of Wayne Bank and Norwood Financial Corp. Sue's experience includes ten years as President and CEO of Gumble Brothers, Inc., a building materials company located in Paupack. She is a welcome addition to our board, bringing a variety of business knowledge from both Florida and the Lake Region of the Poconos in addition to her real estate background and experience as a local business owner.

Wayne Bank is proud to have served its community since 1871. Our community is supported by many nonprofit organizations to which our Directors, officers and employees give their time and energy. We have taken a leadership role in working with the Wayne County YMCA, Wayne Memorial Hospital, Wayne County Builders Association, the Wayne County Chamber of Commerce, Wayne County Historical Society, the Wayne County Community Foundation, the Greater Honesdale Partnership, the Pike County Chamber of Commerce, the Pike County United Way, Pocono Builders Association, Pocono Mountain Chamber of Commerce, the Pocono Mountain Association of Realtors, the Dorflinger-Suydan Wildlife Sanctuary, and the Villaume Foundation, to name just a few.

Although Norwood Financial Corp. is headquartered in Honesdale, with 6 branches located within Wayne County, we have grown steadily and have 3 branches in Pike County as well as 3 branches in Monroe County. Our newest Monroe County branch, in Tannersville, opened in December of 2006. According to the 2000 Census, "Monroe [44.9%], Pike [65.6%], and Wayne [19.5%] counties have the highest population growth rates in the Commonwealth" of Pennsylvania. Our branch expansion serves that population growth.

NET INTEREST INCOME

(Fully taxable equivalent, \$ in thousands) for the year ended December 31

[BAR GRAPH WITH FOLLOWING DATA POINTS:

2002 - \$14,479
2003 - \$13,945
2004 - \$14,653
2005 - \$15,889
2006 - \$16,708

NET CHARGE-OFFS

(\$ in thousands) for the year ended December 31

[BAR GRAPH WITH FOLLOWING DATA POINTS:

2002 - \$700
2003 - \$539
2004 - \$274
2005 - \$129
2006 - \$ 61

We also remodeled the Honesdale Community Branch lobby to create a very stately look with better functionality for the privacy of customers. (The photograph on pages 4 & 5 features the new decor). Two plasma television screens were installed in the lobby to advertise our services and a coin sorter machine was also added as an amenity for our customers.

As you can see, Norwood Financial had a very notable 2006 with strong financial results, a new branch opening and new product launches. Our consistent performance has been noticed by the investment community. We were pleased that Wayne Bank was one of only forty companies awarded "Honor Roll" status by Keefe Bruyette & Woods, a prominent investment banking firm. Keefe Bruyette & Woods includes in its "Honor Roll" those banking institutions that have continually reported increases in earnings per share over the last decade, regardless of the economic environment. The report also highlighted that Norwood's compound annual growth rate in stock price for the period 2000 to 2005 exceeded 23%.

We are always looking for new ways to improve customer service, help our communities prosper, and enhance your shareholder value. In closing, we are proud of our accomplishments and look forward to new challenges and rewards in 2007.

/s/ William W. Davis, Jr.

William W. Davis, Jr., President and Chief Executive Officer

/s/ Russell L. Ridd

Russell L. Ridd, Chairman of the Board

[GRAPHIC OMITTED]

4th of July - 1925

A group of children celebrating on a front porch

717 Main Street
P.O. Box 269
Honesdale, PA 18431

[GRAPHIC OMITTED - MAP]

717 Main Street
Honesdale, PA 18431

245 Willow Avenue
Honesdale, PA 18431

Belmont & Water Streets
Waymart, PA 18472

Route 6
Hawley, PA 18428

111 West Harford Street
Milford, PA 18337

Weis Market, Route 590
Hamlin, PA 18427

Richardson Avenue
Shohola, PA 18458

Route 370 & Lake Como Road
Lakewood, PA 18439

Stroud Mall - R0ute 611
Stroudsburg, PA 18360

Route 739
Lords Valley Shopping Plaza
Lords Valley, PA 18428

Route 209
5165 Milford Road
Marshalls Creek, PA 18335

Route 611
Tannersville, PA 18327

NORWOOD

FINANCIAL CORP

2006
CONSOLIDATED FINANCIAL REPORT

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MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

This Management's Discussion and Analysis and related financial data are presented to assist in the understanding and evaluation of the financial condition and results of operations for Norwood Financial Corp (The Company) and its subsidiary Wayne Bank (the Bank) as of December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005, and 2004. All share and per share amounts have been adjusted to reflect the effect of the 5% stock dividend distributed to shareholders on May 26, 2006. This section should be read in conjunction with the consolidated financial statements and related footnotes.

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, demand for real estate and general economic conditions. The Company undertakes no obligation to publicly release the results of any revisions to those forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

CRITICAL ACCOUNTING POLICIES

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

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

For periods ending prior to January 1, 2006, the Company accounted for stock option plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations. Under APB Opinion No. 25, no stock-based employee compensation was reflected in net income, as all options granted had an exercise price equal to the market value of the underlying common stock on the grant date. The Company adopted SFAS No. 123 (R), "Share-Based Payment" as of January 1, 2006, which requires that transactions be recognized as compensation cost in the income statement based on their fair values on the measurement date, which, for the Company is the grant date. The Norwood Financial Corp.

2006 Stock Option Plan was approved on April 25, 2006 and the Company granted 47,700 options during 2006. For the year ended December 31, 2006 salaries and employee benefit expense includes \$136,000 related to the adoption of Statement No. 123 (R). See Notes 2 and 12 for additional discussion of this pronouncement's impact on the Company's consolidated financial statements.

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

In estimating other-than-temporary impairment losses on securities, the Company considers 1) the length of time and extent to which the fair value has been less than cost 2) the financial condition of the issuer and 3) the intent and ability of the Company to hold the security to allow for a recovery to fair value. The Company believes that the unrealized losses, at December 31, 2006 and 2005 represent temporary impairment of the securities.

RESULTS OF OPERATIONS - SUMMARY

Net income for the Company for the year ended December 31, 2006 totaled \$5,910,000 an increase of \$413,000 or 7.5% over the \$5,497,000 earned for 2005. Basic and diluted earnings per share for 2006 were \$2.11 and \$2.07 respectively, increasing from \$1.96 and \$1.92, respectively in 2005. The return on average assets (ROA) for the year ended December 31, 2006 was 1.33% improving from 1.31% for 2005. Return on average equity also showed improvement at 11.85% in 2006 compared to 11.72% in 2005.

The increase in earnings was principally attributable to an increase in net interest income and a lower level of provision for loan losses. Net interest income on a fully taxable equivalent basis (fte) totaled \$16,708,000 in 2006, compared to \$15,889,000 in 2005, an increase of \$819,000, or 5.2%.

Net interest income was favorably impacted by a \$27.5 million, or 10.0%, increase in average loans receivable for 2006 compared to average loans receivable in 2005. The Company reduced its provision for loan losses to \$220,000 for the year ended December 31, 2006 from \$350,000 for 2005. The decrease was principally due to a lower level of net charge-offs, \$61,000 in 2006 declining from \$129,000 in 2005.

Loans receivable increased \$24.7 million, to total \$315.6 million as of December 31, 2006. The Company had balanced growth throughout the year with the commercial loan portfolio, including commercial real estate, increasing \$12.7 million and loans secured by residential real estate growing \$13.1 million. The majority of the loan growth was funded with a \$17.5 million increase in deposits, principally short-term time deposits.

Other income for 2006 totaled \$3,583,000 compared to \$3,548,000 for 2005. The increase was principally due to \$147,000 of gains on sales of mortgage loans and servicing rights in 2006 compared to \$64,000 in similar gains in 2005. Other expenses totaled \$10,957,000, an increase of \$334,000 or 3.1% over 2005. The increase was primarily due to rising salary and employee benefit costs. The resulting efficiency ratio for 2006 was 54.0% improving from 54.7% in 2005.

The following table sets forth changes in net income (in thousands):

Net income for 2005	\$ 5,497
Net interest income	920
Provision for loan losses	130
Gains on sales of mortgage loans	83
All other income	(48)
Salaries and employee benefits	(245)
Professional fees	104
All other expenses	(193)
Income tax expense	(338)

Net income for 2006	\$ 5,910
	=====

Net income for the Company for the year 2005 totaled \$5,497,000 compared to \$5,010,000 earned in 2004. This represents an increase of \$487,000, or 9.7%, over the prior year. Basic and diluted earnings per share for 2005 were \$1.96 and \$1.92 respectively, increasing from \$1.80 and \$1.77, respectively, in 2004. The return on average assets (ROA) for the year ended December 31, 2005 was 1.31% improving from 1.27% for 2004. Likewise, return on average equity (ROE) for 2005 was 11.72%, increasing from 11.39% in 2004.

The increase in earnings was principally attributable to an increase in net interest income and a lower level of provision for loan losses. Net interest income, on a fully taxable equivalent basis (fte) totaled \$15,889,000 in 2005, compared to \$14,653,000 in 2004, an increase of \$1,236,000, or 8.4%.

The primary driver for the increase in net interest income was an increase in average loans receivable of \$28.3 million, or 11.5%, for the year 2005 compared to the average loans receivable for 2004. The Company reduced its provision for loan losses to \$350,000 for the year ended December 31, 2005 from \$455,000 for 2004. The decrease was due in part to a lower level of net charge-offs in 2005, \$129,000 compared to \$274,000 in 2004.

Loans receivable increased \$36.1 million to total \$290.9 million as of December 31, 2005. The growth was principally related to loans secured by real estate, both commercial, and to a lesser extent, residential. The loan growth was funded by a \$22.0 million growth in deposits, and a \$13 million decrease in Federal Funds sold.

Other income for 2005 was \$3,548,000 compared to \$3,546,000 in 2004. The Company had a significantly lower level of net realized gains on sales of securities, \$42,000 in 2005 compared to \$458,000 in 2004. This was principally offset by \$385,000 increase in service charges and fees. Other income, excluding gains on sales of securities represented 18.1% of total revenues in 2005, improving from 17.4% in 2004. Other expenses totaled \$10,623,000 in 2005 compared to \$10,090,000 in 2004, an increase of \$533,000 or 5.3%. The increase was principally due to higher professional fees and costs related to employee benefit plans.

The following table sets forth changes in net income for the year ended December 31, 2005 compared to the year ended December 31, 2004:

(in thousands)

Net income for 2004	\$ 5,010
Net interest income	1,251
Provision for loan losses	105
Net realized gains on sales of securities	(416)
All other income	418
Salaries and employee benefits	(277)
Professional fees	(121)
All other expenses	(135)
Income tax expense	(338)

Net income for 2005	\$ 5,497
	=====

FINANCIAL CONDITION

TOTAL ASSETS

Total assets as of December 31, 2006, were \$454.4 million compared to \$433.6 million as of year-end 2005, an increase of \$21 million or 4.8%.

LOANS RECEIVABLE

As of December 31, 2006, total loans receivable were \$315.6 million compared to \$290.9 million as of year-end 2005, an increase of \$24.7 million, or 8.5%. Loan growth in commercial and residential real estate was partially offset by a net run-off in indirect automobile financing, which is included in consumer loans to individuals. Loans receivable represented 69.5% of the Company's total assets as of December 31, 2006 compared to 67.1% at year end 2005.

Residential real estate loans, which includes home equity lending, totaled \$113.8 million as of December 31, 2006, compared to \$100.7 million as of year-end 2005. The increase of \$13.1 million is net of prepayments, refinancing activity and sales of mortgage loans into the secondary market. In the relatively low interest rate environment of 2006, fixed rate mortgage products were preferred by the Bank's customers and accounted for the majority of the activity. The Company does not originate any non-traditional mortgage products such as interest-only loans or option adjustable rate mortgages. The Company sells a portion of its long-term fixed rate residential loan production for interest rate risk management, with \$2.1 million of 30 year fixed rate loans sold into the secondary market during 2006. The Company holds the majority of its fifteen and twenty year fixed rate residential mortgage production in its portfolio. The Company also had growth in home equity lending in 2006 through its branch system. Total outstandings increased \$6.3 million to \$49.5 million as of December 31, 2006.

Commercial loans consist principally of loans made to small businesses within the Company's market and are usually secured by real estate or other assets of the borrower. Commercial and commercial real estate loans totaled \$172.9 million as of December 31, 2006, increasing from \$160.3 million as of December 31, 2005, an increase of \$12.6 million or 7.9%. Loans secured by commercial real estate increased \$5.4 million. The terms for commercial real estate loans are typically 15 years, with adjustable rates based on a spread to the

prime rate. The majority of the Company's commercial real estate portfolio is owner occupied and includes the personal guarantees of the principals. The growth in commercial lending was centered in the Pike and Monroe County market areas. Commercial loans consisting principally of lines of credit and term loans secured by equipment or other assets increased \$7.3 million.

The Company's indirect lending portfolio (included in consumer loans to individuals) declined \$2.9 million to \$14.0 million as of December 31, 2006. The Company has de-emphasized this product line due to credit losses and increased pricing competition.

NON-PERFORMING ASSETS AND ALLOWANCE FOR LOAN LOSSES

Non-performing assets consist of non-performing loans and real estate acquired through foreclosure, which is held for sale. Loans are placed on non-accrual status when management believes that a borrower's financial condition is such that collection of interest is doubtful. Commercial and real estate related loans are generally placed on non-accrual when interest is 90 days delinquent. When loans are placed on non-accrual, accrued interest income is reversed from current earnings.

As of December 31, 2006, non-performing loans totaled \$409,000 and represented .13% of total loans receivable compared to \$353,000 and .12% as of year-end 2005. The balance is principally attributable to two credits to one borrower. The loans are secured by real estate and the Company is actively pursuing a resolution. Total non-performing assets, which includes foreclosed real estate totaled \$409,000 and represented .09% of total assets, compared to \$353,000 and .08% as of December 31, 2005. As of December 31, 2006 and 2005, the Company had no foreclosed real estate.

The allowance for loan losses totaled \$3,828,000 as of December 31, 2006 and represented 1.21% of total loans receivable compared to \$3,669,000 and 1.26% of total loans as of year-end 2005. Net charge-offs for 2006 were \$61,000, consisting principally of losses on the sale of repossessed automobiles, compared to net charge-offs of \$129,000 in 2005. The provision for loan losses for 2006 was \$220,000, compared to \$350,000 in 2005.

The Company's loan review process assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes a review of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and a historical review of losses. Other factors considered in the analysis include; concentrations of credit in specific industries in the commercial portfolio; the local and regional economic condition; trends in delinquencies, internal risk rating classifications, and large dollar loans of over \$2 million and growth in the portfolio. As of December 31, 2006, the Company considered its concentration of credit risk profile to be acceptable. The local economy was stable in 2006, with a slight decrease in the unemployment rate in its primary market area of Wayne, Pike and Monroe Counties. The Company has modestly increased its number of large commercial credits and had double digit growth in commercial and real estate related loans. As a result of its analysis, after applying these factors, management considers the allowance as of December 31, 2006 adequate. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any, that might be incurred in the future.

The following table sets forth information with respect to the Company's allowance for loan losses at the dates indicated:

	Year-ended December 31,				
	(in thousands)				
	2006	2005	2004	2003	2002
Allowance balance at beginning of period	\$ 3,669	\$ 3,448	\$ 3,267	\$ 3,146	\$ 3,216
Charge-offs:					
Commercial and all other	--	(4)	(19)	(121)	(34)
Real Estate	--	(6)	(10)	--	(122)
Consumer	(150)	(200)	(342)	(478)	(608)
Lease Financing	--	--	(11)	(36)	(30)
Total	(150)	(210)	(382)	(635)	(794)
Recoveries:					
Commercial and all other	18	12	13	5	--
Real Estate	2	18	8	24	13
Consumer	65	46	78	64	72
Lease Financing	4	5	9	3	9
Total	89	81	108	96	94
Provision expense	220	350	455	660	630
Allowance balance at end of period	\$ 3,828	\$ 3,669	\$ 3,448	\$ 3,267	\$ 3,146
Allowance for loan losses as a percent of total loans outstanding	1.21%	1.26%	1.35%	1.40%	1.44%
Net loans charged off as a percent of average loans outstanding	.02%	.05%	.11%	.24%	.33%
Allowance coverage of non-performing loans	9.4x	10.4x	51.5x	22.8x	14.2x

The following table sets forth information regarding non-performing assets. The Bank had no troubled debt restructurings as defined in FAS No. 114. As of December 31, 2006, the Company had \$290,000 impaired and collateral dependent loans compared to \$310,000 at year-end 2005.

	As of December 31,				
	(in thousands)				
	2006	2005	2004	2003	2002
Non-accrual loans:					
Commercial and all other	\$ --	\$ --	\$ --	\$ --	\$ --
Real estate	392	330	32	125	213
Consumer	17	11	8	--	3
Total	409	341	40	125	216
Accruing loans which are contractually past due 90 days or more	--	12	27	18	5
Total non-performing loans	409	353	67	143	221
Foreclosed real estate	--	--	--	--	21
Total non-performing assets	\$ 409	\$ 353	\$ 67	\$ 143	\$ 242
Non-performing loans to total loans	.13%	.12%	.03%	.06%	.10%
Non-performing loans to total assets	.09%	.08%	.02%	.04%	.06%
Non-performing assets to total assets	.09%	.08%	.02%	.04%	.07%

SECURITIES

The securities portfolio consists principally of issues of United States Government agencies, including mortgage-backed securities, municipal obligations, and corporate debt. In accordance with SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" the Company classifies its investments into two categories: held to maturity (HTM) and available for sale (AFS). The Company does not have a trading account. Securities classified as HTM are those in which the Company has the ability and the intent to hold the security until contractual maturity. As of December 31, 2006, the HTM portfolio totaled \$954,000 and consisted entirely of municipal obligations. Securities classified as AFS are eligible to be sold due to liquidity needs or interest rate risk management. These securities are adjusted to and carried at their fair market value with any unrealized gains or losses recorded as an adjustment to capital and reported in the equity section of the balance sheet as other comprehensive income (loss), net of deferred income taxes. As of December 31, 2006, \$112.9 million in securities were so classified and carried at their fair market value, with unrealized depreciation; net of tax, of \$44,000, included in Accumulated other comprehensive loss in stockholders' equity.

As of December 31, 2006, the average life of the portfolio was 2.1 years. The Company has maintained a relatively short average life in the portfolio in order to generate cash flows to support loan growth. Purchases for the year totaled \$32.3 million with securities called, maturities and principal reductions of \$36.0 million and proceeds from sales of \$96,000. The purchases were funded principally by cash flow from the portfolio. As of December 31, the carrying value of the Company's securities portfolio (HTM and AFS) totaled \$113.9 million with the mix as follows:

	2006		2005	
	(dollars in thousands)			
	Carrying Value	% of portfolio	Carrying Value	% of portfolio
US Treasury Securities	\$ --	--%	\$ 1,989	1.7%
US Government agencies	47,581	41.9	51,996	44.3
States and political subdivisions	17,419	15.3	21,175	18.1
Corporate obligations	8,439	7.4	10,450	8.9
Mortgage-backed securities	38,652	33.8	29,954	25.5
Equity securities	1,775	1.6	1,702	1.5
Total	\$ 113,866	100.0%	\$ 117,266	100.0%

The portfolio had \$17.7 million of floating rate instruments, principally adjustable rate mortgage backed securities as of December 31, 2006 compared to \$11.4 million at year end 2005. The portfolio contained no structured notes, step-up bonds and no off-balance sheet derivatives were in use. The U.S. Government agency portfolio consists principally of callable notes with final maturities of generally less than five years. The mortgage backed securities are pass-through bonds with the Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corp (Freddie Mac), and Guaranteed National Mortgage Association (GNMA). During 2006, the Company increased its holdings of mortgage-backed securities with the expectation that the bonds will provide regular cash flow.

DEPOSITS

The Company, through the twelve branches of the Bank, provides a full range of deposit products to its retail and business customers. These products include interest-bearing and non-interest bearing transaction accounts, statement savings and money market accounts. Time deposits consist of certificates of deposit (CDs) with terms of up to five years and include Individual Retirement Accounts. The Bank participates in the Jumbo CD (\$100,000 and over) markets with local municipalities and school districts, which are typically awarded on a competitive bid basis.

Total deposits as of December 31, 2006, totaled \$358.1 million increasing from \$340.6 million as of year-end 2005, an increase of \$17.5 million or 5.1%. The increase was principally in time deposits as the Bank offered competitive rates on short-term CDs. The Company's money market deposit and savings deposit products decreased \$10.3 million reflecting depositors' preference for short-term time deposits in 2006 to take advantage of higher short-term interest rates.

Time deposits over \$100,000, which consist principally of school district and other public funds, with maturities generally less than one year, were \$56.7 million as of December 31, 2006, compared to \$48.9 million at year-end 2005. The increase was principally due to a higher level of jumbo CDs with local school districts. These deposits are subject to competitive bid and the Company bases its bid on current interest rates, loan demand, investment portfolio structure and the relative cost of other funding sources. The Company also had short-term time deposits of \$9.1 million from commercial customers as of December 31, 2006.

As of December 31, 2006, non-interest bearing demand deposits totaled \$53.9 million, increasing \$3.0 million or 5.8% from the prior year-end. This growth is partially attributable to an increase in commercial deposits, related to the increase in the commercial loan portfolio. In addition, a portion of the growth is due to the Bank's "Simply Free" retail checking product. Interest-bearing demand accounts totaled \$36.6 million as of December 31, 2006 compared to \$40.7 million at year end 2005. The decrease is principally due to certain municipal accounts converting to cash management accounts. Cash management accounts included in short-term borrowings, totaled \$20.7 million at year end 2006 compared to \$12.5 million. These balances represent commercial and municipal customers' funds invested in over-night securities. The Company considers these accounts as a source of core funding.

The Company believes a portion of its deposit growth over the prior three years may have been due in part to the relatively low interest rate environment which offered limited opportunities to earn higher yields. Bank deposit growth in core deposits did slow in 2006, as the stock market became more attractive to investors, competition for deposits increased among banks, and customers took advantage of higher time deposit rates. However, the Company believes it can continue to increase its core deposits by establishing new commercial loan relationships, and by seeking new branch locations in high growth areas.

MARKET RISK

Interest rate sensitivity and the repricing characteristics of assets and liabilities are managed by the Asset and Liability Management Committee (ALCO). The principal objective of ALCO is to maximize net interest income within acceptable levels of risk, which are established by policy. Interest rate risk is monitored and managed by using financial modeling techniques to measure the impact of changes in interest rates.

Net interest income, which is the primary source of the Company's earnings, is impacted by changes in interest rates and the relationship of different interest rates. To manage the impact of the rate changes, the balance sheet should be structured so that repricing opportunities exist for both assets and liabilities at approximately the same time intervals. The Company uses net interest simulation to assist in interest rate risk management. The process includes simulating various interest rate environments and their impact on net interest income. As of December 31, 2006, the level of net interest income at risk in a 200 basis points increase or decrease was within the Company's policy limits, of a decline less than 8% of net interest income.

Imbalance in repricing opportunities at a given point in time reflect interest-sensitivity gaps measured as the difference between rate-sensitive assets and rate-sensitive liabilities. These are static gap measurements that do not take into account any future activity, and as such are principally used as early indications of potential interest rate exposures over specific intervals.

At December 31, 2006, the Bank had a positive 90 day interest sensitivity gap of \$24.0 million or 5.3% of total assets. A positive gap indicates that the balance sheet has more rate-sensitive assets (RSA) than

rate-sensitive liabilities (RSL) at the time interval. This would indicate that in a rising rate environment, the yield on interest-earning assets would increase faster than the cost of interest-bearing liabilities in the 90 day time frame. The level of RSA and RSL for an interval is managed by ALCO strategies, including adjusting the average life of the investment portfolio through purchase and sales, pricing of deposit liabilities to attract longer term time deposits, loan pricing to encourage variable rate products and evaluation of loan sales of long term fixed rate mortgages.

The Company analyzes and measures the time periods in which RSA and RSL will mature or reprice in accordance with their contractual terms and assumptions. Management believes that the assumptions used are reasonable. The interest rate sensitivity of assets and liabilities could vary substantially if differing assumptions were used or if actual experience differs from the assumptions used in the analysis. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in differing degrees to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Interest rates may change at different rates changing the shape of the yield curve. This was evident in 2006 as the Federal Funds rate increased 100 basis points, while the two to ten year treasury bond yields increased about 40 basis points. As a result the yield curve was inverted for most of 2006 as short-term rates were higher than long-term rates. Further, in the event of a significant change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed. Finally, the ability of borrowers to service their adjustable-rate debt may decrease in the event of an interest rate increase. We do not believe that the operating results of the Company are subject to foreign currency exchange or commodity price risk.

The following table displays interest-sensitivity as of December 31, 2006 (in thousands):

	3 Months or Less	3-12 Months	1-3 Years	Greater than 3 Years	Total
Interest-bearing deposits	\$ 67	\$ --	\$ --	\$ --	\$ 67
Securities	19,348	32,837	34,324	27,357	113,866
Loans Receivable	95,019	48,739	70,478	101,331	315,567
Total Rate Sensitive Assets (RSA)	\$ 114,434	\$ 81,576	\$ 104,802	\$ 128,688	\$ 429,500
Non-maturity interest bearing deposits	\$ 20,583	\$ 22,435	\$ 59,406	\$ 29,368	\$ 131,792
Time Deposits	55,976	86,304	22,024	8,151	172,455
Other	13,913	7,264	14,559	--	35,736
Total Rate Sensitive Liabilities (RSL)	\$ 90,472	\$ 116,003	\$ 95,989	\$ 37,519	\$ 339,983
Interest Sensitivity Gap	\$ 23,962	\$ (34,427)	\$ 8,813	\$ 91,169	\$ 89,517
Cumulative Gap	23,962	(10,465)	(1,652)	89,517	
RSA/RSL-Cumulative	126.5%	94.9%	99.5%	126.3%	
As of December 31, 2005					
Interest Sensitivity Gap	\$ 24,402	\$ (5,676)	\$ 1,642	\$ 56,582	\$ 76,950
Cumulative Gap	24,402	18,726	20,368	76,950	
RSA/RSL-Cumulative	126.5%	110.7%	107.1%	123.2%	

LIQUIDITY

Liquidity is the ability to fund customers' borrowing needs and their deposit withdrawal requests while supporting asset growth. The Company's primary sources of liquidity include deposit generation, asset maturities, and cash flow from payments on loans and securities.

As of December 31, 2006, the Company had cash and cash equivalents of \$9.5 million in the form of cash, due from banks, and short-term deposits with other institutions. In addition, the Company had total securities available for sale of \$112.9 million, which could be used for liquidity needs. This totals \$122.4 million and represents 26.9% of total assets compared to \$125.6 million and 29% of total assets as of December 31, 2005. The change was principally due to the lower level of securities available for sale as of December 31, 2006. The Company used the proceeds from the investment portfolio to fund loan growth. The Company also monitors other liquidity measures, all of which were within the Company's policy guidelines as of December 31, 2006. Based upon these measures, the Company believes its liquidity position is adequate.

The Company maintains established lines of credit with the Federal Home Loan Bank of Pittsburgh (FHLB), the Atlantic Central Bankers Bank (ACBB) and other correspondent banks, which support liquidity needs. The total available under all the lines was \$46 million, with \$-0- outstanding at December 31, 2006. The maximum borrowing capacity from FHLB was \$216.9 million. As of year-end 2006, the Company had \$13 million in term borrowings from the FHLB, decreasing from \$23 million in similar borrowings from the FHLB as of December 31, 2005.

OFF-BALANCE SHEET ARRANGEMENTS

The Company's 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 mainly of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. Unused commitments, as of December 31, 2006 totaled \$54.0 million. They consisted of \$18.3 million in commercial real estate, construction and land developments loans, \$10.6 million in home equity lines of credit, \$7.2 million in standby letters of credit and \$17.9 million in other unused commitments principally commercial lines of credit. Because these instruments have fixed maturity dates and because many of them will expire without being drawn upon, they do not represent any significant liquidity risk.

Management believes that any amounts actually drawn upon can be funded in the normal course of operations. The Company has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources.

CONTRACTUAL OBLIGATIONS

The following table represents the aggregate on and off balance sheet contractual obligations to make future payments (in thousands):

(In thousands)

	December 31, 2006				
	Total	Less than 1 year	1-3 years	4-5 years	Over 5 years
Time deposits	\$ 172,455	\$ 142,281	\$ 22,024	\$ 8,150	\$ --
Long-term debt	13,000	--	10,000	3,000	--
Operating leases	4,011	271	472	467	2,801
	<u>\$ 189,466</u>	<u>\$ 142,552</u>	<u>\$ 32,496</u>	<u>\$ 11,617</u>	<u>\$ 2,801</u>

RESULTS OF OPERATIONS

NET INTEREST INCOME

The following analysis should be read in conjunction with the "Consolidated Average Balance Sheets with Resultant Interest and Rates" and "Rate/Volume Analysis" tables.

Net interest income is the most significant source of revenue for the Company and represented 81.9% of total revenue for the year ended December 31, 2006. Net interest income on a fully taxable equivalent basis (fte)

totalled \$16,708,000, for the year ended December 31, 2006 compared to \$15,889,000 for 2005, an increase of \$819,000, or 5.2%. The resulting fte net interest spread and fte net interest margin were 3.36% and 3.96%, respectively in 2006 compared to 3.58% and 3.99% respectively in 2005.

Interest income (fte) for the year ended December 31, 2006 totalled \$26,474,000 an increase of \$4,080,000 over \$22,394,000 in 2005. The fte yield on average earning assets for 2006 was 6.27% increasing from 5.62% in 2005. The increase in interest income was principally due to higher yields on loans and investments, growth in average earning assets and a higher percentage of loans on the balance sheet. The prime rate of interest and other short-term interest rates reflected a steady increase from June 2004 to June 2006. During that period the prime rate increased from 4.00% to 8.25%. This has improved the yield on the Company's floating rate loans, principally commercial real estate and commercial lines of credit, which are tied to the prime rate. As of December 31, 2006, \$78.8 million of loans were immediately reparable. Average earning assets for 2006 totalled \$422.0 million, an increase of \$23.9 million over the average for 2005. The mix of earning assets also improved with higher yield loans representing 71.2% of average earning assets in 2006 compared to 68.8% in 2005.

Interest income (fte) earned on loans totalled \$21,600,000 for the year ended December 31, 2006 with a resulting fte yield of 7.16% compared to \$17,727,000 with a fte yield of 6.47% in 2005. Rising short-term interest rates and an increase in average volume of \$27.4 million, or 10.0%, were responsible for the improvement in income and yield.

The securities available for sale portfolio averaged \$116.6 million during 2006, with fte interest income of \$4,637,000 and a fte yield of 3.98% compared to \$116.6 million with fte interest income of \$4,139,000 and a fte yield of 3.55% in 2005. The increase in yield was due to re-investment of cash flows from the portfolio into higher yielding instruments, due to the increase in short-term interest rates.

Interest expense for the year ended December 31, 2006 totalled \$9,766,000, an increase of \$3,261,000 over \$6,505,000 in 2005. The increase was principally due to higher short term interest rates and a more expensive mix of interest-bearing liabilities in 2006. The Company incurred higher costs for time deposits, in 2006 at 3.96% compared to 2.82% in 2005. The cost of time deposits was influenced by competitive pressures, and higher short-term rates. The Company expects the cost of short-term deposits to increase again in 2007. Higher interest rates also impacted the cost of money market accounts and short-term borrowings. The mix of average interest-bearing liabilities was also more expensive in 2006, with average time deposits and short-term borrowings representing 49.3% of the total compared to 45.4% on average in 2005.

Net interest income represented 81.8% of total revenue for the year ended December 31, 2005. Net interest income (fte) totalled \$15,889,000 for 2005, an increase of \$1,236,000, or 8.4%, over the amount earned in the year-ended December 31, 2004. The resulting fte net interest spread and net interest margin for 2005 were 3.58% and 3.99%, respectively, compared to 3.60% and 3.91%, respectively, in 2004.

Interest income (fte) for the year ended December 31, 2005 totalled \$22,394,000 compared to \$19,647,000 in 2004. The yield (fte) on average earning assets for 2005 was 5.62% increasing from 5.25% in 2004. The increase in interest income was principally due to growth in average earning assets, a higher percentage of loans on the balance sheet, and an increase in the prime rate. Average earning assets increased \$23.6 million or 6.3%. The mix of earning assets improved with loans representing 68.8% of average earning assets during 2005 compared to 65.6% during 2004. Prime rate and short-term interest rates reflected a steady increase from June 2004 through December 2005. During that period, the prime rate increased from 4.00% to 7.25%. This improved the yield on the Company's floating rate loans, principally commercial real estate, tied to prime rate. As of December 31, 2005, \$79.6 million of loans were immediately reparable.

Interest income earned on loans during 2005 totaled \$17,727,000 with a yield of 6.47%, increasing from \$14,912,000 and a yield of 6.07% during 2004. An increase in average volume of \$28.3 million, or 11.5% and increasing interest rates were responsible for the improvement in income and yield.

The securities available for sale portfolio averaged \$116.6 million during 2005, with interest income of \$4,139,000 and a yield of 3.55%. This represented very little change from 2004, which had an average balance of \$118.3 million, interest income of \$4,159,000 and a yield of 3.52%. Total cash flow from sales, maturities, calls and principal reductions on mortgage-backed securities totaled \$17.9 million in 2005 declining from \$49.5 million in 2004. Proceeds in 2005 were generally reinvested in short-term callable U. S. Government agency instruments and mortgage-backed securities. The Company has kept the portfolio relatively short due to a flattening treasury yield curve in 2005.

Interest expense for the year-ended December 31, 2005 totaled \$6,505,000 compared to \$4,994,000 in 2004. The average cost of interest-bearing liabilities increased 39 basis points to 2.04% for 2005 from 1.65% in 2004. The increase was due to rising short-term interest rates. This impacted the Company's cost of time deposits which increased 51 basis points to 2.82%.

OTHER INCOME

Other income totaled \$3,583,000 for the year-ended December 31, 2006 compared to \$3,548,000 in 2005. Service charges and fees decreased \$52,000 to \$2,455,000. The decrease was partially due to \$26,000 decline in service charges on deposit accounts reflecting growth in the Bank's no fee retail checking products. Loan related services decreased \$79,000 due in part to a lower level of letter of credit fees and no-fee loan promotions conducted in 2006.

Income from fiduciary activities totaled \$355,000 in 2006 increasing \$12,000 from 2005. The increase was principally due to \$9.9 million growth in assets under management which totaled \$96.9 million as of December 31, 2006.

Gains on sales of mortgage loans and servicing rights, included in Other, totaled \$147,000 in 2006 compared to \$64,000 in 2005. The increase was due to the gain on sale of \$13.7 million of mortgage servicing rights on loans previously sold in the secondary market to FNMA. The Company does not expect similar gains on the sale of servicing rights in 2007.

Other income totaled \$3,548,000 for the year ended December 31, 2005 compared to \$3,546,000 in 2004.

Service charges and fees increased \$385,000 to \$2,507,000 for 2005. The increase was principally due to a higher level of overdraft (nsf) fees which increased \$373,000. Service charges on deposit accounts decreased \$53,000 to \$322,000 reflecting growth in the Bank's no-fee retail checking product.

Income from fiduciary activities totaled \$343,000 in 2005, increasing \$42,000 from 2004. The increase was partially due to a \$10,000 growth in estate fees. In addition, the market value of assets under management increased \$3.6 million to \$87.0 million.

The Company had a lower level of net realized gains on sales of securities in 2005 at \$42,000 declining from \$458,000 in 2004. Total securities sold in 2005 totaled \$6.1 million compared to \$11.7 million in 2004. The decrease in gains is due in part to the increase in interest rates in 2005, which adversely impacts the value of securities.

Total gains on sales of mortgage loans, included in Other were \$64,000 on sales of \$6.7 million in 2005, compared to \$67,000 on sales of \$4.1 million in 2004. The loans sold were principally 30 year fixed rate residential mortgages. The sales were for interest rate risk management to reduce the Company's exposure in long-term fixed rate assets.

Other Income (dollars in thousands)
For the year-ended December 31

	2006	2005	2004
Service charges on deposit accounts	\$ 296	\$ 322	\$ 375
ATM Fees	224	215	219
NSF Fees	1,260	1,265	892
Safe Deposit Box Rental	55	56	57
Loan related service fees	271	350	324
Debit Card	282	253	213
Fiduciary activities	355	343	301
Mutual funds & annuities	131	150	154
Gain on sales of mortgage loans and servicing assets	147	64	67
CSV on life insurance	309	296	316
Other income	187	192	170
	3,517	3,506	3,088
Net realized gains on sales of securities	66	42	458
Total	\$3,583	\$3,548	\$3,546

OTHER EXPENSES

Other expenses for the year ended December 31, 2006 totaled \$10,957,000, an increase of \$334,000 or 3.15% over \$10,623,000 in 2005.

Salaries and employee benefits expense, which represented 51.6% of total expense, increased \$245,000 or 4.5% to \$5,655,000 in 2006. The cost of health insurance premiums paid by the Company for its employees increased \$105,000 in 2006. The Company incurred \$136,000 of expense related to stock options granted in 2006 as a result of adopting FASB Statement No. 123 (R) "Share Based Payment". The Company had expense of \$444,000 related to its employee stock ownership plan (ESOP) in 2006 compared to \$588,000 in 2005. The ESOP had a ten year life and was fully funded as of September 30, 2006.

Furniture and equipment expense decreased \$96,000 to \$479,000 in 2006 principally due to lower maintenance expense. Data processing related operations totaled \$700,000 in 2006 compared to \$625,000 in 2005. The increase was due to enhancement to the Bank's on-line banking product and implementation of software related to image based check processing. Advertising expense increased \$65,000 to \$224,000 in 2006 reflecting increased use of radio advertising. Professional fees decreased \$104,000 due to a lower level of corporate legal fees and accounting services.

Other expenses for the year ended December 31, 2005 totaled \$10,623,000, an increase of \$533,000, or 5.3%, over the \$10,090,000 in 2004. Salaries and employee benefits, which represented 50.9% of total other expense, increased \$277,000, or 5.4% to \$5,410,000 in 2005. The increase was principally due to increasing costs related to the Company's Employee Stock Ownership Plan (ESOP), which increased \$57,000 due to appreciation in the Company's stock price and health insurance premiums which increased \$59,000.

Occupancy costs increased \$115,000 to \$928,000 for 2005. This was principally due to the full year effect of the Marshalls Creek Office which opened in August 2004 and increases in real estate taxes. Data processing related expenses totaled \$625,000 in 2005 compared to \$598,000 in 2004. The increase reflects costs associated with enhancing the Bank's on-line banking service. The Company disposed of its final leased vehicles in

2004, therefore, there was no loss on lease residuals in 2005, compared to \$90,000 in 2004. Professional fees totaled \$444,000 in 2005 increasing from \$323,000 in 2004. This includes an increase of \$76,000 to \$238,000 for accounting services reflecting expenses associated with the internal control documentation required by Sarbanes-Oxley.

INCOME TAXES

Income tax expense for the year ended December 31, 2006 totaled \$2,679,000 for an effective tax rate of 31.2% compared to an expense of \$2,341,000 and an effective tax rate of 29.9% for 2005. The higher effective tax rate was principally due to a lower level of tax exempt interest income and the tax effect of compensation expense related to stock options.

Income tax expense for the year ended December 31, 2005 totaled \$2,341,000 for an effective tax rate of 29.9% compared to an expense of \$2,003,000 an effective tax rate of 28.6% in 2004. The increase in the effective tax rate was principally due to a lower level of tax exempt interest income in 2005.

CAPITAL AND DIVIDENDS

Total stockholders' equity as of December 31, 2006, was \$52.2 million, compared to \$48.1 million as of year-end 2005. The increase was principally due to retention of earnings of \$3,542,000 after cash dividends declared of \$2,368,000. Accumulated other comprehensive income increased \$728,000 due to market value changes in the Company's AFS securities portfolio principally as a result of changing interest rates. As of December 31, 2006 the Company had a leverage capital ratio of 11.43%, Tier 1 risk-based capital of 15.67% and total risk-based capital of 16.99% compared to, 11.05%, 15.29% and 16.63%, respectively, at year end 2005.

The Company's stock is traded on the Nasdaq Global market under the symbol, NWFL. As of December 31, 2006, there were approximately 1,400 shareholders based on transfer agent mailings.

The following table sets forth the price range and cash dividends declared per share regarding common stock for the period indicated:

	Closing Price Range		Cash dividend declared per share
	High	Low	
Year 2005			
First Quarter	\$ 34.18	\$ 24.24	\$.1714
Second Quarter	32.47	28.57	.1714
Third Quarter	31.43	29.32	.1714
Fourth Quarter	31.74	29.33	.20
Year 2006			
First Quarter	\$ 31.16	\$ 29.59	\$.20
Second Quarter	33.75	30.24	.21
Third Quarter	32.00	31.07	.21
Fourth Quarter	31.68	30.22	.23

The book value of the common stock was \$18.67 as of December 31, 2006 compared to \$17.07 as of December 31, 2005. As of year-end 2006, the stock price was \$31.50, compared to \$31.71 as of December 31, 2005.

STOCK PERFORMANCE GRAPH

Set forth below is a stock performance graph comparing the cumulative total shareholder return on the Common Stock with (a) the cumulative total stockholder return on stocks included in the Nasdaq Stock Market index and (b) the cumulative total stockholder return on stocks included in the Nasdaq Bank index, as prepared for Nasdaq by the Center for Research in Securities Prices ("CRSP") at the University of Chicago. All three investment comparisons assume the investment of \$100 at the market close on December 31, 2001 and the reinvestment of dividends paid. The graph provides comparison at December 31, 2001 and each fiscal year through December 31, 2006.

[Line graph appears here showing 5-year cumulative total return on \$100 invested in the Common Stock compared to cumulative total returns on \$100 invested in the Nasdaq Bank Index and Nasdaq Index, respectively. Line graph starts at December 31, 2001 and shows the cumulative total returns at December 31, 2002, 2003, 2004, 2005 and 2006. Plot points are shown below]

	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
Norwood Financial Corp.	100.0	117.8	161.2	220.8	206.0	217.0
Nasdaq Stock Market (US Companies)	100.0	69.1	103.4	112.5	114.9	126.2
Nasdaq Bank Stocks	100.0	102.4	131.7	150.7	147.2	165.2

There can be no assurance that the Company's future stock performance will be the same or similar to the historical performance shown in the above graph. The Company neither makes nor endorses any predictions as to stock performance.

NORWOOD FINANCIAL CORP.
SUMMARY OF QUARTERLY RESULTS (UNAUDITED)
(Dollars in thousands, except per share amounts)

2006	December 31	September 30	June 30	March 31
Interest income	\$6,956	\$6,647	\$6,350	\$5,996
Interest expense	2,830	2,545	2,321	2,070
Net interest income	4,126	4,102	4,029	3,926
Provision for loan losses	50	45	55	70
Other income	862	849	989	817
Net realized gains on sales of securities	--	45	14	7
Other expense	2,620	2,730	2,841	2,766
Income before income taxes	2,318	2,221	2,136	1,914
Income tax expense	739	699	660	581
NET INCOME	\$1,579	\$1,522	\$1,476	\$1,333
Basic earnings per share	\$ 0.56	\$ 0.54	\$ 0.53	\$ 0.48
Diluted earnings per share	\$ 0.55	\$ 0.53	\$ 0.52	\$ 0.47

2005	December 31	September 30	June 30	March 31
Interest income	\$ 5,904	\$5,578	\$5,313	\$4,973
Interest expense	1,941	1,644	1,517	1,403
Net interest income	3,963	3,934	3,796	3,570
Provision for loan losses	70	90	90	100
Other income	896	905	862	843
Net realized gain (loss) on sales of securities	(41)	3	3	77
Other expense	2,668	2,627	2,677	2,651
Income before income taxes	2,080	2,125	1,894	1,739
Income tax expense	638	643	564	496
NET INCOME	\$ 1,442	\$1,482	\$1,330	\$1,243
Basic earnings per share	\$ 0.52	\$ 0.53	\$ 0.47	\$ 0.44
Diluted earnings per share	\$ 0.51	\$ 0.52	\$ 0.46	\$ 0.43

NORWOOD FINANCIAL CORP. CONSOLIDATED AVERAGE BALANCE SHEETS WITH RESULTANT INTEREST AND RATES
(Tax-Equivalent Basis, dollars in thousands)

Year Ended December 31	2006			2005		
	Average Balance(2)	Interest(1)	Ave Rate	Average Balance(2)	Interest(1)	Ave Rate
ASSETS						
Interest Earning Assets:						
Federal funds sold	\$ 2,778	\$ 142	5.11%	\$ 3,730	\$ 129	3.46%
Interest bearing deposits with banks	98	5	5.10	123	3	2.44
Securities held to maturity	981	90	9.17	3,608	396	10.98
Securities available for sale						
Taxable	99,571	3,712	3.73	98,038	3,116	3.18
Tax-exempt	17,070	925	5.42	18,602	1,023	5.50
Total securities available for sale	116,641	4,637	3.73	116,640	4,139	3.55
Loans receivable (3,4)	301,533	21,600	7.16	274,053	17,727	6.47
Total interest earning assets	422,031	26,474	6.27	398,154	22,394	5.62
Non-interest earning assets:						
Cash and due from banks	8,857			8,569		
Allowance for loan losses	(3,785)			(3,597)		
Other assets	16,976			16,049		
Total non-interest earning assets	22,048			21,021		
TOTAL ASSETS	\$444,079			\$419,175		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-Bearing Liabilities:						
Interest-bearing demand and money market	\$ 96,882	\$ 1,688	1.74	\$ 93,747	969	1.03
Savings	49,937	232	0.46	57,128	268	0.47
Time	146,344	5,798	3.96	128,704	3,634	2.82
Total interest-bearing deposits	293,163	7,718	2.63	279,579	4,871	1.74
Short-term borrowings	19,284	823	4.27	15,783	416	2.64
Long term debt	23,419	1,225	5.23	23,000	1,218	5.30
Total interest bearing liabilities	335,866	9,766	2.91	318,362	6,505	2.04
Non-interest bearing liabilities						
Non-interest bearing demand deposits	54,798			52,109		
Other liabilities	3,526			1,804		
Total non-interest bearing liabilities	58,324			53,913		
Stockholders' equity	49,889			46,900		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$444,079			\$419,175		
Net interest income (tax-equivalent basis)		16,708	3.36%		15,889	3.58%
Tax-equivalent basis adjustment		(525)			(626)	
Net Interest Income		\$16,183			\$15,263	
Net Interest margin(tax-equivalent basis)			3.96%			3.99%

Year Ended December 31	2004		
	Average Balance(2)	Interest(1)	Ave Rate
ASSETS			
Interest Earning Assets:			
Federal funds sold	\$ 4,648	\$ 68	1.46%
Interest bearing deposits with banks	120	2	1.67
Securities held to maturity	5,732	506	8.83
Securities available for sale			
Taxable	100,180	3,127	3.12
Tax-exempt	18,080	1,032	5.71
Total securities available for sale	118,260	4,159	3.52
Loans receivable (3,4)	245,783	14,912	6.07
Total interest earning assets	374,543	19,647	5.25

Non-interest earning assets:			
Cash and due from banks	8,542		
Allowance for loan losses	(3,376)		
Other assets	14,846		

Total non-interest earning assets	20,012		

TOTAL ASSETS	\$394,555		
	=====		
LIABILITIES AND STOCKHOLDERS' EQUITY			
Interest-Bearing Liabilities:			
Interest-bearing demand and money market	\$ 89,851	549	0.61
Savings	58,243	273	0.47
Time	118,512	2,733	2.31

Total interest-bearing deposits	266,606	3,555	1.33
Short-term borrowings	12,965	151	1.16
Long term debt	23,000	1,288	5.60

Total interest bearing liabilities	302,571	4,994	1.65

Non-interest bearing liabilities			
Non-interest bearing demand deposits	47,399		
Other liabilities	596		

Total non-interest bearing liabilities	47,995		

Stockholders' equity	43,989		

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$394,555		
	=====		
Net interest income (tax-equivalent basis)		14,653	3.60%
			====
Tax-equivalent basis adjustment		(641)	

Net Interest Income		\$14,012	
		=====	
Net Interest margin(tax-equivalent basis)			3.91%
			====

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

RATE/VOLUME ANALYSIS

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

(dollars in thousands)	INCREASE/(DECREASE)					
	2006 COMPARED TO 2005			2005 COMPARED TO 2004		
	VARIANCE DUE TO			VARIANCE DUE TO		
	VOLUME	RATE	NET	VOLUME	RATE	NET
INTEREST EARNING ASSETS:						
Federal funds sold	\$ (38)	\$ 51	\$ 13	\$ (16)	\$ 77	\$ 61
Interest bearing deposits with banks	(1)	3	2	--	1	1
Securities held to maturity	(250)	(56)	(306)	(215)	105	(110)
Securities available for sale						
Taxable	49	547	596	(68)	57	(11)
Tax-exempt	(83)	(15)	(98)	29	(38)	(9)
Total securities available for sale	(34)	532	498	(39)	19	(20)
Loans receivable	1,870	2,003	3,873	1,787	1,028	2,815
Total interest earning assets	1,547	2,533	4,080	1,517	1,230	2,747
INTEREST BEARING LIABILITIES:						
Interest-bearing demand and money market	33	686	719	25	395	420
Savings	(33)	(3)	(36)	(5)	--	(5)
Time	549	1,615	2,164	250	651	901
Total interest-bearing deposits	549	2,298	2,847	270	1,046	1,316
Short-term borrowings	107	300	407	39	276	265
Long term debt	22	(15)	7	--	(70)	(70)
Total interest bearing liabilities	678	2,583	3,261	309	1,202	1,511
Net interest income (tax-equivalent basis)	\$ 869	\$ (50)	\$ 819	\$1,208	\$ 28	\$ 1,236

Changes in net interest income that could not be specifically identified as either a rate or volume change were allocated proportionately to changes in volume and changes in rate.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Norwood Financial Corp.
Honesdale, Pennsylvania

We have audited the accompanying consolidated balance sheets of Norwood Financial Corp. and its subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Norwood Financial Corp. and its subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for share-based payments in 2006.

/s/ Beard Miller Company LLP

Beard Miller Company LLP
Reading, Pennsylvania
February 26, 2007

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
	2006	2005
	(IN THOUSANDS, EXCEPT SHARE DATA)	
ASSETS		
Cash and due from banks	\$ 9,450	\$ 9,746
Interest bearing deposits with banks	67	70

Cash and Cash Equivalents	9,517	9,816
Securities available for sale	112,912	115,814
Securities held to maturity, fair value 2006 \$971; 2005 \$1,480	954	1,452
Loans receivable, net of allowance for loan losses 2006 \$3,828; 2005 \$3,669	311,739	287,221
Investment in FHLB stock, at cost	1,687	1,620
Bank premises and equipment, net	6,020	5,393
Bank owned life insurance	7,479	7,213
Accrued interest receivable	2,129	1,812
Other assets	1,919	3,215

TOTAL ASSETS	\$ 454,356	\$ 433,556
	=====	
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing demand	\$ 53,856	\$ 50,891
Interest-bearing demand	36,600	40,738
Money market deposit accounts	50,048	52,194
Savings	45,144	53,311
Time	172,455	143,469

TOTAL DEPOSITS	358,103	340,603
Short-term borrowings	22,736	18,564
Long-term debt	13,000	23,000
Accrued interest payable	2,894	1,691
Other liabilities	5,392	1,590

TOTAL LIABILITIES	402,125	385,448
STOCKHOLDERS' EQUITY		
Common stock, par value \$.10 per share; authorized 10,000,000 shares; issued 2006: 2,840,872 2005: 2,705,715 shares	284	270
Surplus	10,149	5,648
Retained earnings	43,125	43,722
Treasury stock, at cost 2006 43,721 shares; 2005 21,189 shares	(1,283)	(633)
Accumulated other comprehensive loss	(44)	(772)
Unearned Employee Stock Ownership Plan (ESOP) shares	--	(127)

TOTAL STOCKHOLDERS' EQUITY	52,231	48,108

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 454,356	\$ 433,556
	=====	

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF INCOME

	YEARS ENDED DECEMBER 31,		
	2006	2005	2004
(IN THOUSANDS, EXCEPT PER SHARE DATA)			
INTEREST INCOME			
Loans receivable, including fees	\$21,422	\$17,583	\$14,794
Securities:			
Taxable	3,712	3,116	3,127
Tax exempt	668	937	1,015
Other	147	132	70
TOTAL INTEREST INCOME	25,949	21,768	19,006
INTEREST EXPENSE			
Deposits	7,718	4,871	3,555
Short-term borrowings	823	416	151
Long-term debt	1,225	1,218	1,288
TOTAL INTEREST EXPENSE	9,766	6,505	4,994
NET INTEREST INCOME	16,183	15,263	14,012
PROVISION FOR LOAN LOSSES	220	350	455
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	15,963	14,913	13,557
OTHER INCOME			
Service charges and fees	2,455	2,507	2,122
Income from fiduciary activities	355	343	301
Net realized gains on sales of securities	66	42	458
Earnings on life insurance policies	309	296	316
Other	398	360	349
TOTAL OTHER INCOME	3,583	3,548	3,546
OTHER EXPENSES			
Salaries and employee benefits	5,655	5,410	5,133
Occupancy	968	928	813
Furniture and equipment	479	575	542
Data processing related operations	700	625	598
Losses on lease residuals	--	--	90
Advertising	224	159	156
Professional fees	340	444	323
Postage and telephone	471	470	471
Taxes, other than income	354	334	276
Amortization of intangible assets	52	52	52
Other	1,714	1,626	1,636
TOTAL OTHER EXPENSES	10,957	10,623	10,090
INCOME BEFORE INCOME TAXES	8,589	7,838	7,013
INCOME TAX EXPENSE	2,679	2,341	2,003
NET INCOME	\$ 5,910	\$ 5,497	\$ 5,010
EARNINGS PER SHARE			
Basic	\$ 2.11	\$ 1.96	\$ 1.80
Diluted	\$ 2.07	\$ 1.92	\$ 1.77

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

	NUMBER OF SHARES ISSUED	COMMON STOCK	SURPLUS	RETAINED EARNINGS	TREASURY STOCK	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	UNEARNED ESOP SHARES	TOTAL
(Dollars in Thousands, Except Per Share Data)								
BALANCE - DECEMBER 31, 2003	2,705,715	\$270	\$ 4,933	\$37,042	\$ (295)	\$ 1,431	\$(550)	\$42,831
Comprehensive income:								
Net income	-	-	-	5,010	-	-	-	5,010
Change in unrealized gains on securities available for sale, net of reclassification adjustment and tax effects	-	-	-	-	-	(1,098)	-	(1,098)
Total Comprehensive Income								3,912
Cash dividends declared, \$.66 per share	-	-	-	(1,830)	-	-	-	(1,830)
Stock options exercised	-	-	(21)	-	227	-	-	206
Tax benefit of stock options exercised	-	-	22	-	-	-	-	22
Acquisition of treasury stock	-	-	-	-	(118)	-	-	(118)
Release of treasury stock for ESOP	-	-	40	-	37	-	-	77
Release of earned ESOP shares, net	-	-	362	-	-	-	223	585
BALANCE - DECEMBER 31, 2004	2,705,715	270	5,336	40,222	(149)	333	(327)	45,685
Comprehensive income:								
Net income	-	-	-	5,497	-	-	-	5,497
Change in unrealized gains on securities available for sale, net of reclassification adjustment and tax effects	-	-	-	-	-	(1,105)	-	(1,105)
Total Comprehensive Income								4,392
Cash dividends declared, \$.71 per share	-	-	-	(1,997)	-	-	-	(1,997)
Stock options exercised	-	-	(78)	-	228	-	-	150
Tax benefit of stock options exercised	-	-	18	-	-	-	-	18
Acquisition of treasury stock	-	-	-	-	(819)	-	-	(819)
Release of treasury stock for ESOP	-	-	7	-	107	-	-	114
Release of earned ESOP shares, net	-	-	365	-	-	-	200	565
BALANCE - DECEMBER 31, 2005	2,705,715	270	5,648	43,722	(633)	(772)	(127)	48,108
Comprehensive income:								
Net income	-	-	-	5,910	-	-	-	5,910
Change in unrealized gains (losses) on securities available for sale, net of reclassification adjustment and tax effects	-	-	-	-	-	728	-	728
Total Comprehensive Income								6,638
Cash dividends declared, \$.85 per share	-	-	-	(2,368)	-	-	-	(2,368)
5% stock dividend at \$30.59 per share	135,157	14	4,121	(4,139)	-	-	-	(4)
Acquisition of treasury stock	-	-	-	-	(890)	-	-	(890)
Stock options exercised	-	-	(68)	-	128	-	-	60
Tax benefit of stock options exercised	-	-	10	-	-	-	-	10
Release of treasury stock for ESOP	-	-	8	-	112	-	-	120
Compensation expense related to stock options	-	-	136	-	-	-	-	136
Release of earned ESOP shares, net	-	-	294	-	-	-	127	421
BALANCE - DECEMBER 31, 2006	2,840,872	\$284	\$10,149	\$43,125	\$(1,283)	\$ (44)	\$ -	\$52,231

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,		
	2006	2005	2004
	(IN THOUSANDS)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 5,910	\$ 5,497	\$ 5,010
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	220	350	455
Depreciation	503	535	544
Amortization of intangible assets	52	52	52
Deferred income taxes	(108)	(37)	(81)
Net amortization of securities premiums and discounts	301	431	540
Net realized gains on sales of securities	(66)	(42)	(458)
Net increase in investment in life insurance	(266)	(254)	(283)
Gain on sale of bank premises and equipment and foreclosed real estate	(12)	(5)	(12)
Gain on sale of mortgage loans and servicing rights	(147)	(64)	(67)
Mortgage loans originated for sale	(2,065)	(6,650)	(4,101)
Proceeds from sale of mortgage loans	2,212	6,714	4,168
Tax benefit of stock options exercised	--	18	22
Release of ESOP shares	421	565	585
Compensation expense related to stock options	136	--	--
Decrease (increase) in accrued interest receivable and other assets	1,137	(1,725)	884
Increase (decrease) in accrued interest payable and other Liabilities	4,543	1,575	(200)
Net Cash Provided by Operating Activities	12,771	6,960	7,058
CASH FLOWS FROM INVESTING ACTIVITIES			
Securities available for sale:			
Proceeds from sales	96	6,073	11,687
Proceeds from maturities and principal reductions on mortgage-backed securities	35,962	11,799	37,779
Purchases	(32,291)	(18,878)	(43,331)
Securities held to maturity, proceeds from maturities	505	4,330	35
(Increase) decrease in investment in FHLB stock	(67)	605	(223)
Net increase in loans	(24,892)	(36,374)	(21,579)
Purchase of bank premises and equipment	(1,130)	(446)	(445)
Proceeds from sales of premises and equipment and foreclosed real estate	64	12	42
Net Cash Used in Investing Activities	(21,753)	(32,879)	(16,035)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in deposits	17,500	21,958	11,976
Net increase (decrease) in short-term borrowings	4,172	(4,418)	10,123
Proceeds from long-term debt	--	5,000	--
Repayments of long-term debt	(10,000)	(5,000)	--
Stock options exercised	60	150	206
Tax benefit of stock options exercised	10	--	--
ESOP purchase of shares from treasury stock	120	114	77
Acquisition of treasury stock	(890)	(819)	(118)
Cash dividends paid	(2,289)	(1,916)	(1,795)
Net Cash Provided by Financing Activities	8,683	15,069	20,469
Net Increase (Decrease) in Cash and Cash Equivalents	(299)	(10,850)	11,492
CASH AND CASH EQUIVALENTS - BEGINNING	9,816	20,666	9,174
CASH AND CASH EQUIVALENTS - ENDING	\$ 9,517	\$ 9,816	\$ 20,666

See notes to consolidated financial statements

NOTE 1 - NATURE OF OPERATIONS

Norwood Financial Corp. (Company) is a one bank holding company. Wayne Bank (Bank) is a wholly-owned subsidiary of the Company. The Bank is a state-chartered bank located in Honesdale, Pennsylvania. The Company derives substantially all of its income from the bank related services which include interest earnings on commercial mortgages, residential real estate mortgages, commercial and consumer loans, as well as interest earnings on investment securities and fees from deposit services to its customers. The Company is subject to regulation and supervision by the Federal Reserve Board while the Bank is subject to regulation and supervision by the Federal Deposit Insurance Corporation and the Pennsylvania Department of Banking.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

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

ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of deferred tax assets, and the determination of other-than-temporary impairment on securities.

SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Most of the Company's activities are with customers located within northeastern Pennsylvania. Note 3 discusses the types of securities that the Company invests in. Note 4 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations to any one industry or customer.

CONCENTRATIONS OF CREDIT RISK

The Bank operates primarily in Wayne, Pike and Monroe Counties in Pennsylvania and, accordingly, has extended credit primarily to commercial entities and individuals in this area whose ability to honor their contracts is influenced by the region's economy. These customers are also the primary depositors of the Bank. The Bank is limited in extending credit by legal lending limits to any single borrower or group of borrowers.

SECURITIES

Securities classified as available for sale are those securities that the Company intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Securities available for sale are carried at fair value. Unrealized gains and losses are reported in other comprehensive income, net of the related deferred tax effect. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using a method which approximates the interest method over the term of the security.

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

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

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Federal law requires a member institution of the Federal Home Loan Bank system to hold stock of its district Federal Home Loan Bank according to a predetermined formula. This restricted stock is carried at cost.

LOANS RECEIVABLE

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees. Interest income is accrued on the unpaid principal balance. Loan origination fees are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Company is generally amortizing these amounts over the contractual life of the loan.

The accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential real estate loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

PREMISES AND EQUIPMENT

Premises and equipment are stated at cost less accumulated depreciation. Depreciation expense is calculated principally on the straight-line method over the respective assets estimated useful lives as follows:

	YEARS

Buildings and improvements	10 - 40
Furniture and equipment	3 - 10

TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets, including loan and loan participation sales, are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

FORECLOSED REAL ESTATE

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less cost to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of its carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses. Foreclosed real estate is included in other assets.

BANK OWNED LIFE INSURANCE

The Company invests in bank owned life insurance ("BOLI") as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Bank on a chosen group of employees. The Company is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from the increase in cash surrender value of the policies is included in other income on the consolidated statement of income.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INTANGIBLE ASSETS

Intangible assets represent goodwill arising from acquisitions. Goodwill represents the excess cost of an acquisition over the fair value of the net assets acquired. On January 1, 2002, the Company adopted SFAS 142, "Goodwill and Other Intangible Assets," and SFAS 147, "Accounting for Certain Acquisitions of Banking and Thrift Institutions." At December 31, 2006 and 2005, the Company had intangible assets of \$221,000 and \$273,000, which is net of accumulated amortization of \$559,000 and \$507,000, which are included in other assets. These intangible assets will continue to be amortized on a straight-line basis over fifteen years under the provisions of SFAS 142 and SFAS 147. Amortization expense related to intangible assets was \$52,000 for each of the years ended December 31, 2006, 2005 and 2004.

INCOME TAXES

Deferred income tax assets and liabilities are determined based on the differences between financial statement carrying amounts and the tax basis of existing assets and liabilities. These differences are measured at the enacted tax rates that will be in effect when these differences reverse. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company and its subsidiary file a consolidated federal income tax return.

ADVERTISING COSTS

The Company follows the policy of charging the costs of advertising to expense as incurred.

EARNINGS PER SHARE

On April 11, 2006, the Company declared a 5% stock dividend on common stock outstanding payable May 26, 2006 to shareholders of record on May 12, 2006. The stock dividend resulted in the issuance of 135,157 additional common shares. All share amounts and per share data have been adjusted for the effect of the stock dividend

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

STOCK OPTION PLANS

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (R), "Share-Based Payment." Statement No. 123 (R) replaces Statement No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." Statement No. 123 (R) requires the fair value of share-based payment transactions to be recognized as compensation costs in the financial statements over the period that an employee provides service in exchange for the award. The fair value of the share-based payments is estimated using the Black-Scholes option-pricing model. The Company adopted Statement No. 123 (R) effective January 1, 2006, using the modified-prospective transition method. Under the modified prospective method, companies are required to record compensation cost for new and modified awards over the related vesting period of such awards and record compensation cost prospectively for the unvested portion, at the date of adoption, of previously issued and outstanding awards over the remaining vesting period of such awards. No change to prior periods presented is permitted under the modified prospective method. The Company did not issue any stock options in 2005. All outstanding options as of December 31, 2005 were fully vested.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

For the years ended December 31, 2005 and 2004, the Company accounted for its stock option plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

	YEARS ENDED DECEMBER 31,	
	2005	2004
	(THOUSANDS, EXCEPT PER SHARE DATA)	
Net income, as reported	\$ 5,497	\$ 5,010
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related taxes	(194)	(143)
Pro forma net income	\$ 5,303	\$ 4,867
Earnings per share (basic):		
As reported	\$ 1.96	\$ 1.80
Pro forma	\$ 1.89	\$ 1.75
Earnings per share (assuming dilution):		
As reported	\$ 1.92	\$ 1.77
Pro forma	\$ 1.85	\$ 1.71

CASH FLOW INFORMATION

For the purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks and federal funds sold.

Cash payments for interest for the years ended December 31, 2006, 2005 and 2004 were \$8,563,000, \$6,014,000, and \$5,103,000, respectively. Cash payments for income taxes for the years ended December 31, 2006, 2005 and 2004 were \$2,677,000, \$2,449,000, and \$1,941,000, respectively. Non-cash investing activities for 2006, 2005 and 2004 included foreclosed mortgage loans transferred to foreclosed real estate and repossession of other assets of \$154,000, \$112,000, and \$281,000, respectively.

OFF-BALANCE SHEET FINANCIAL INSTRUMENTS

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, letters of credit and commitments to sell loans. Such financial instruments are recorded in the consolidated balance sheets when they become receivable or payable.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

TRUST ASSETS

Assets held by the Company in a fiduciary capacity for customers are not included in the financial statements since such items are not assets of the Company. Trust income is reported on the accrual method.

COMPREHENSIVE INCOME

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	YEARS ENDED DECEMBER 31,		
	2006	2005	2004
	(IN THOUSANDS)		
Unrealized holding gains/ (losses) on available for sale securities	\$ 1,173	\$(1,636)	\$(1,204)
Reclassification adjustment for gains realized in income	66	42	458
Net Unrealized Gains/(Losses)	1,107	(1,678)	(1,662)
Income tax expense (benefit)	379	(573)	(564)
Net of Tax Amount	\$ 728	\$(1,105)	\$(1,098)

SEGMENT REPORTING

The Company acts as an independent community financial service provider and offers traditional banking and related financial services to individual, business and government customers. Through its branch and automated teller machine network, the Company offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer and mortgage loans; and the providing of safe deposit services. The Company also performs personal, corporate, pension and fiduciary services through its Trust Department.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial, retail, mortgage banking and trust operations of the Company. As such, discrete information is not available and segment reporting would not be meaningful.

NEW ACCOUNTING STANDARDS

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments". SFAS No. 155 amends FASB Statement No. 133 and FASB Statement No. 140, and improves the financial reporting of certain hybrid financial instruments by requiring more consistent accounting that eliminates exemptions and provides a means to simplify the accounting for these instruments. Specifically, SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company is required to adopt the provisions of SFAS No. 155, as applicable, beginning in fiscal year 2007. Management does not believe the adoption of SFAS No. 155 will have a material impact on the Company's consolidated financial position and results of operations.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - An Amendment of FASB Statement No. 140" ("SFAS 156"). SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. SFAS 156 is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006, which for the Company will be as of the beginning of fiscal 2007. The Company does not believe that the adoption of SFAS 156 will have a significant effect on its consolidated financial statements.

In February 2006, the FASB issued FASB Staff Position No. FAS 123(R)-4, "Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event." This position amends SFAS 123R to incorporate that a cash settlement feature that can be exercised only upon the occurrence of a contingent event that is outside the employee's control does not meet certain conditions in SFAS 123R until it becomes probable that the event will occur. The guidance in this FASB Staff Position shall be applied upon initial adoption of Statement 123R. The Company is currently evaluating the impact that the adoption of SFAS 123R will have on its consolidated financial statements.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that companies recognize in their financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are currently evaluating the impact of adopting FIN 48 on our consolidated financial statements.

In September 2006, the FASB issued FASB Statement No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. FASB Statement No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. We are currently evaluating the potential impact, if any, of the adoption of FASB Statement No. 157 on our consolidated financial position, results of operations and cash flows.

On September 13, 2006, the Securities and Exchange Commission "SEC" issued Staff Accounting Bulletin No. 108 ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, Companies might evaluate the materiality of financial-statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company's balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statements misstatements as material if they are material according to either the income statement or balance sheet approach. The Company has analyzed SAB 108 and determined that upon adoption it will have no impact on the reported results of operations or financial condition.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In September 2006, the FASB's Emerging Issues Task Force (EITF) issued EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements" ("EITF 06-4"). EITF 06-4 requires the recognition of a liability related to the postretirement benefits covered by an endorsement split-dollar life insurance arrangement. The consensus highlights that the employer (who is also the policyholder) has a liability for the benefit it is providing to its employee. As such, if the policyholder has agreed to maintain the insurance policy in force for the employee's benefit during his or her retirement, then the liability recognized during the employee's active service period should be based on the future cost of insurance to be incurred during the employee's retirement. Alternatively, if the policy holder has agreed to provide the employee with a death benefit, then the liability for the future death benefit should be recognized by following the guidance in SFAS No. 106 or Accounting Principals Board (APB) Opinion No. 12, as appropriate. For transition, an entity can choose to apply the guidance using either of the following approaches: (a) a change in accounting principle through retrospective application to all periods presented or (b) a change in accounting principle through a cumulative-effect adjustment to the balance in retained earnings at the beginning of the year of adoption. The disclosures are required in fiscal years beginning after December 15, 2007, with early adoption permitted. The Company does not believe that the implementation of this guidance will have a material impact on the Company's consolidated financial statements.

In October 2006, the FASB issued FASB Staff Position No. 123(R)-5, "Amendment of FASB Staff Position FAS 123(R)-1" ("FSP 123(R)-5"). FSP 123(R)-5 amends FSP 123(R)-1 for equity instruments that were originally issued as employee compensation and then modified, with such modification made solely to reflect an equity restructuring that occurs when the holders are no longer employees. The Company does not expect the adoption of FSP 123(R)-5 to have a material impact on its financial condition, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for our Company January 1, 2008. The Company is evaluating the impact that the adoption of SFAS No. 159 will have on our consolidated financial statements.

NOTE 3 - SECURITIES

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

DECEMBER 31, 2006				
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
(IN THOUSANDS)				
AVAILABLE FOR SALE:				
U.S. Government agencies	\$ 48,117	\$ 10	\$ (546)	\$ 47,581
States and political subdivisions	16,572	73	(180)	16,465
Corporate obligations	8,552	--	(113)	8,439
Mortgage-backed securities	39,123	98	(569)	38,652
	112,364	181	(1,408)	111,137
Equity securities	593	1,182	--	1,775
	\$112,957	\$1,363	\$ (1,408)	\$ 112,912
HELD TO MATURITY:				
States and political subdivisions	\$ 954	\$ 17	\$ --	\$ 971

DECEMBER 31, 2005				
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
(IN THOUSANDS)				
AVAILABLE FOR SALE:				
U.S. Treasuries	\$ 2,008	\$ -	\$ (19)	\$ 1,989
U.S. Government agencies	53,180	-	(1,184)	51,996
States and political subdivisions	19,810	141	(228)	19,723
Corporate obligations	10,708	2	(260)	10,450
Mortgage-backed securities	30,675	17	(738)	29,954
	116,381	160	(2,429)	114,112
Equity securities	586	1,118	(2)	1,702
	\$116,967	\$1,278	\$ (2,431)	\$115,814
HELD TO MATURITY:				
States and political subdivisions	\$ 1,452	\$ 28	\$ -	\$ 1,480

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

DECEMBER 31, 2006						
	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
(IN THOUSANDS)						
U.S. Government agencies	\$ 9,966	\$ (32)	\$ 34,605	\$ (514)	\$ 44,571	\$ (546)
States and political subdivisions	3,104	(8)	8,064	(172)	11,168	(180)
Corporate obligations	--	--	7,440	(113)	7,440	(113)
Mortgage-backed securities	4,952	(35)	21,419	(534)	26,371	(569)
	\$ 18,022	\$ (75)	\$ 71,528	\$ (1,333)	\$ 89,550	\$ (1,408)

DECEMBER 31, 2005

	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
	(In Thousands)					
U.S. Treasuries	\$ -	\$ -	\$ 1,989	\$ (19)	\$ 1,989	\$ (19)
U.S. Government agencies	11,378	(122)	40,618	(1,062)	51,996	(1,184)
States and political subdivisions	6,014	(78)	4,797	(150)	10,811	(228)
Corporate obligations	-	-	9,452	(260)	9,452	(260)
Mortgage-backed securities	14,675	(225)	14,380	(513)	29,055	(738)
Equity securities	34	(2)	-	-	34	(2)
	\$ 32,101	\$ (427)	\$ 71,236	\$ (2,004)	\$ 103,337	\$ (2,431)

At December 31, 2006, the Company had 20 securities in the less than twelve month category and 92 securities in the twelve months or more category. In management's opinion, the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. Management believes that the unrealized losses represent temporary impairment of the securities, as the Company has the intent and ability to hold these investments until maturity or market price recovery.

The amortized cost and fair value of debt securities as of December 31, 2006 by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	AVAILABLE FOR SALE		HELD TO MATURITY	
	AMORTIZED COST	FAIR VALUE	AMORTIZED COST	FAIR VALUE
	(IN THOUSANDS)			
Due in one year or less	\$ 32,157	\$ 31,835	\$ --	\$ --
Due after one year through five years	30,106	29,632	--	--
Due after five years through ten years	8,883	8,923	414	429
Due after ten years	2,095	2,095	540	542
	73,241	72,485	954	971
Mortgage-backed securities	39,123	38,652	--	--
	\$ 112,364	\$ 111,137	\$ 954	\$ 971

Gross realized gains and gross realized losses on sales of securities available for sale were \$66,000 and \$-0-, respectively, in 2006, \$107,000 and \$65,000, respectively, in 2005, and \$475,000 and \$17,000, respectively, in 2004.

Securities with a carrying value of \$50,677,000 and \$41,959,000 at December 31, 2006 and 2005, respectively, were pledged to secure public deposits, U.S. Treasury demand notes, securities sold under agreements to repurchase and for other purposes as required or permitted by law.

NOTE 4 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The components of loans receivable at December 31 were as follows:

	2006	2005

(IN THOUSANDS)		
Real estate:		
Residential	\$ 113,783	\$ 100,705
Commercial	138,881	133,495
Construction	7,714	5,944
Commercial, financial and agricultural	34,019	26,755
Consumer loans to individuals	21,520	24,353
	-----	-----
	315,917	291,252
Unearned income and deferred fees	(350)	(362)
Allowance for loan losses	(3,828)	(3,669)
	-----	-----
	\$ 311,739	\$ 287,221
	=====	=====

The following table presents changes in the allowance for loan losses:

	YEARS ENDED DECEMBER 31,		
	2006	2005	2004

(IN THOUSANDS)			
Balance, beginning	\$ 3,669	\$ 3,448	\$ 3,267
Provision for loan losses	220	350	455
Recoveries	89	81	108
Loans charged off	(150)	(210)	(382)
	-----	-----	-----
Balance, ending	\$ 3,828	\$ 3,669	\$ 3,448
	=====	=====	=====

The recorded investment in impaired loans, not requiring an allowance for loan losses was \$290,000 and \$310,000 at December 31, 2006 and 2005, respectively. The recorded investment in impaired loans requiring an allowance for loan losses was \$-0- at December 31, 2006 and 2005. For the years ended December 31, 2006, 2005 and 2004, the average recorded investment in these impaired loans was \$286,000, \$316,000, and \$-0-, and the interest income recognized on these impaired loans was \$1,000, \$11,000, and \$-0-, respectively.

Loans on which the accrual of interest has been discontinued amounted to \$409,000 and \$341,000 at December 31, 2006 and 2005, respectively. Loan balances past due 90 days or more and still accruing interest, but which management expects will eventually be paid in full, amounted to \$-0- and \$12,000 at December 31, 2006 and 2005, respectively.

NOTE 5 - PREMISES AND EQUIPMENT

Components of premises and equipment at December 31 are as follows:

	2006	2005

(In Thousands)		
Land and improvements	\$ 925	\$ 925
Buildings and improvements	7,766	7,318
Furniture and equipment	4,638	3,956
	-----	-----
Accumulated depreciation	13,329	12,199
	(7,309)	(6,806)
	-----	-----
	\$ 6,020	\$ 5,393
	=====	=====

NOTE 5 - PREMISES AND EQUIPMENT (CONTINUED)

Certain facilities are leased under various operating leases. Rental expense for these leases was \$222,000, \$203,000, and \$147,000, for the years ended December 31, 2006, 2005 and 2004. Future minimum rental commitments under noncancellable leases as of December 31, 2006 were as follows (in thousands):

2007	\$ 271
2008	241
2009	231
2010	228
2011	239
Thereafter	2,801

	\$4,011
	=====

NOTE 6 - DEPOSITS

Aggregate time deposits in denominations of \$100,000 or more were \$56,736,000 and \$48,857,000 at December 31, 2006 and 2005, respectively.

At December 31, 2006, the scheduled maturities of time deposits are as follows (in thousands):

2007	\$142,281
2008	17,713
2009	4,311
2010	3,897
2011	4,253

	\$172,455
	=====

NOTE 7 - BORROWINGS

Short-term borrowings at December 31 consist of the following:

	2006	2005

	(IN THOUSANDS)	
Securities sold under agreements to repurchase	\$21,736	\$12,464
Federal funds purchased	--	5,100
U.S. Treasury demand notes	1,000	1,000
	-----	-----
	\$22,736	\$18,564
	=====	=====

The outstanding balances and related information of short-term borrowings are summarized as follows:

	YEARS ENDED DECEMBER 31,	

	2006	2005

	(DOLLARS IN THOUSANDS)	
Average balance during the year	\$22,209	\$15,059
Average interest rate during the year	4.39%	2.76%
Maximum month-end balance during the year	\$29,677	\$24,956
Weighted average interest rate at the end of the year	4.20%	3.76%

Securities sold under agreements to repurchase generally mature within one day to one year from the transaction date. Securities with an amortized cost and fair value of \$24,535,000 and \$24,270,000 at December 31, 2006 and \$14,768,000 and \$14,396,000 at December 31, 2005 were pledged as collateral for these agreements. The securities underlying the agreements were under the Company's control.

NOTE 7 - BORROWINGS (CONTINUED)

The Company has a line of credit commitment available from the Federal Home Loan Bank (FHLB) of Pittsburgh for borrowings of up to \$20,000,000 which expires in December 2011. There were no borrowings under this line at December 31, 2006 and 2005. The Company has a line of credit commitment available from PNC for \$12,000,000, Atlantic Central Bankers Bank for \$7,000,000 and Wachovia Bank for \$2,000,000. There were no borrowings under these lines of credit at December 31, 2006 and 2005. The Company had a line of credit commitment available from the Bank of Lancaster County for \$5,000,000 at December 31, 2006 and for \$8,000,000 at December 31, 2005. There was \$-0- outstanding under this line of credit at December 31, 2006 and \$5,100,000 at December 31, 2005.

Long-term debt consisted of the following at December 31, 2006 and 2005:

	2006	2005

	(IN THOUSANDS)	
Notes with the Federal Home Loan Bank (FHLB):		
Convertible note due December 2006 at 6.19%	\$ --	\$ 5,000
Fixed rate note due April 2008 at 4.17%	5,000	5,000
Convertible note due April 2009 at 5.53% and 4.83%	5,000	5,000
Convertible note due April 2009 at 5.07%	--	5,000
Convertible note due January 2011 at 5.24%	3,000	3,000

	\$13,000	\$23,000
	=====	

The convertible notes contain an option which allows the FHLB, at quarterly intervals, to change the note to an adjustable-rate advance at three-month LIBOR plus 11 to 16 basis points. If the notes are converted, the option allows the Bank to put the funds back to the FHLB at no charge.

Contractual maturities of long-term debt at December 31, 2006 are as follows (in thousands):

2007	\$ --
2008	5,000
2009	5,000
2010	--
2011	3,000
Thereafter	--

	\$13,000
	=====

The Bank's maximum borrowing capacity with the Federal Home Loan Bank was \$216,869,000 of which \$13,000,000 was outstanding at December 31, 2006. Advances from the Federal Home Loan Bank are secured by qualifying assets of the Bank.

NOTE 8 - EMPLOYEE BENEFIT PLANS

The Company has a defined contributory profit-sharing plan which includes provisions of a 401(k) plan. The plan permits employees to make pre-tax contributions between 2% and 10% of the employee's compensation. The amount of contributions to the plan, including matching contributions, is at the discretion of the Board of Directors. All employees over the age of 21 are eligible to participate in the plan after one year of employment. Employee contributions are vested at all times, and any Company contributions are fully vested after five years. The Company's contributions are expensed as the cost is incurred, funded currently, and amounted to \$181,000, \$207,000, and \$185,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

NOTE 8 - EMPLOYEE BENEFIT PLANS (CONTINUED)

The Company has a non-qualified supplemental executive retirement plan for the benefit of certain executive officers. At December 31, 2006 and 2005, other liabilities include approximately \$858,000 and \$720,000 accrued under the Plan. Compensation expense includes approximately \$138,000, \$140,000, and \$130,000, relating to the supplemental executive retirement plan for 2006, 2005 and 2004, respectively. To fund the benefits under this plan, the Company is the owner of single premium life insurance policies on participants in the non-qualified retirement plan. At December 31, 2006 and 2005, the cash value of these policies was \$7,479,000 and \$7,213,000, respectively.

The Company has a leveraged employee stock ownership plan ("ESOP") for the benefit of employees who meet the eligibility requirements which include having completed one year of service with the Company and having attained age twenty-one. The ESOP Trust purchased shares of the Company's common stock with proceeds from a loan from the Company. The Bank makes cash contributions to the ESOP on an annual basis sufficient to enable the ESOP to make the required loan payments. The loan bears interest at the prime rate adjusted annually. Interest is payable annually and principal payable in equal annual installments over ten years. The loan is secured by the shares of the stock purchased.

As the debt is repaid, shares are released from collateral and allocated to qualified employees based on the proportion of debt service paid in the year. The Company accounts for its leveraged ESOP in accordance with Statement of Position 93-6. Accordingly, the shares pledged as collateral are reported as unallocated ESOP shares in the consolidated balance sheets. As shares are released from collateral, the Company reports compensation expense equal to the current market price of the shares, and the shares become outstanding for earnings per share computations. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings and dividends on unallocated ESOP shares are recorded as a reduction of debt. Dividends recorded as a reduction of debt were \$12,000 and \$23,000 for the years ended December 31, 2006 and 2005, respectively. The total employer contribution was \$143,000 and \$193,000 for the years ended December 31, 2006 and 2005, respectively.

Compensation expense for the ESOP was \$444,000, \$588,000, and \$530,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

The status of the ESOP shares at December 31 are as follows:

	2006	2005
	-----	-----
Allocated shares	162,690	151,125
Shares released from allocation	28,219	25,466
Unreleased shares	--	14,318
	-----	-----
TOTAL ESOP SHARES	190,909	190,909
	-----	-----
Fair value of unreleased shares	\$ --	\$440,000
	=====	=====

NOTE 9 - INCOME TAXES

The components of the provision for federal income taxes are as follows:

	YEARS ENDED DECEMBER 31,		
	2006	2005	2004
	-----	-----	-----
	(IN THOUSANDS)		
Current	\$ 2,787	\$ 2,378	\$ 2,084
Deferred	(108)	(37)	(81)
	-----	-----	-----
	\$ 2,679	\$ 2,341	\$ 2,003
	=====	=====	=====

NOTE 9 - INCOME TAXES (CONTINUED)

Deferred income taxes reflect temporary differences in the recognition of revenue and expenses for tax reporting and financial statement purposes, principally because certain items, such as, the allowance for loan losses and loan fees are recognized in different periods for financial reporting and tax return purposes. A valuation allowance has not been established for deferred tax assets. Realization of the deferred tax assets is dependent on generating sufficient taxable income. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized. Deferred tax assets are recorded in other assets.

Income tax expense of the Company is less than the amounts computed by applying statutory federal income tax rates to income before income taxes because of the following:

	PERCENTAGE OF INCOME BEFORE INCOME TAXES		
	YEARS ENDED DECEMBER 31,		
	2006	2005	2004
Tax at statutory rates	34.0%	34.0%	34.0%
Tax exempt interest income, net of interest expense disallowance	(3.6)	(4.7)	(5.6)
Increase in fair market value of ESOP	1.2	1.6	1.7
Incentive stock options compensation expense	0.5	-	-
Earnings on life insurance	(1.0)	(1.1)	(1.4)
Other	0.1	0.1	(0.1)
	31.2%	29.9%	28.6%

The income tax provision includes \$22,000, \$14,000, and \$156,000, of income taxes relating to realized securities gains for the years ended December 31, 2006, 2005, and 2004, respectively.

The net deferred tax asset included in other assets in the accompanying consolidated balance sheets includes the following amounts of deferred tax assets and liabilities:

	2006	2005
	(IN THOUSANDS)	
Deferred tax assets:		
Allowance for loan losses	\$1,142	\$1,070
Deferred compensation	292	252
Intangible assets	94	120
Net unrealized losses on securities	1	380
Other	21	4
Total Deferred Tax Assets	1,550	1,826
Deferred tax liabilities:		
Premises and equipment	215	254
Deferred loan fees	305	271
Total Deferred Tax Liabilities	520	525
Net Deferred Tax Asset	\$1,030	\$1,301

NOTE 10 - TRANSACTIONS WITH EXECUTIVE OFFICERS AND DIRECTORS

Certain directors and executive officers of the Company, their families and their affiliates are customers of the Bank. Any transactions with such parties, including loans and commitments, were in the ordinary course of business at normal terms, including interest rates and collateralization, prevailing at the time and did not represent more than normal risks. At December 31, 2006 and 2005 such loans amounted to \$5,959,000 and \$3,130,000, respectively. During 2006, new loans to such related parties totaled \$3,360,000 and repayments and other reductions aggregated \$531,000.

NOTE 11 - REGULATORY MATTERS AND STOCKHOLDERS' EQUITY

The Company and Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2006, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2006, the most recent notification from the regulators has categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are presented in the table:

	ACTUAL		FOR CAPITAL ADEQUACY PURPOSES		TO BE WELL CAPITALIZED UNDER PROMPT CORRECTIVE ACTION PROVISIONS	
	AMOUNT	RATIO	AMOUNT	RATIO	AMOUNT	RATIO
(Dollars in Thousands)						
AS OF DECEMBER 31, 2006:						
Total capital (to risk-weighted assets)	\$55,017	16.73%	\$=>26,308	=>8.00%	\$=>32,885	=>10.00%
Tier 1 capital (to risk-weighted assets)	50,800	15.45	=>13,153	=>4.00	=>19,728	=>6.00
Tier 1 capital (to average assets)	50,800	11.15	=>18,224	=>4.00	=>22,780	=>5.00
AS OF DECEMBER 31, 2005:						
Total capital (to risk-weighted assets)	\$51,033	16.41%	\$=>24,879	=>8.00%	\$=>31,098	=>10.00%
Tier 1 capital (to risk-weighted assets)	46,986	15.11	=>12,438	=>4.00	=>18,658	=>6.00
Tier 1 capital (to average assets)	46,986	10.84	=>17,338	=>4.00	=>21,673	=>5.00

The Company's ratios do not differ significantly from the Bank's ratios presented above.

The Bank is required to maintain average cash reserve balances in vault cash or with the Federal Reserve Bank. The amount of these restricted cash reserve balances at December 31, 2006 and 2005 was approximately \$253,000 and \$308,000, respectively.

NOTE 11 - REGULATORY MATTERS AND STOCKHOLDERS' EQUITY (CONTINUED)

Under Pennsylvania banking law, the Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. At December 31, 2006, \$44,816,000 of retained earnings were available for dividends without prior regulatory approval, subject to the regulatory capital requirements discussed above. Under Federal Reserve regulations, the Bank is limited as to the amount it may lend affiliates, including the Company, unless such loans are collateralized by specific obligations.

NOTE 12 - STOCK OPTION PLANS

The Company's shareholders approved the Norwood Financial Corp 2006 Stock Option Plan at the Annual Meeting on April 26, 2006. An aggregate of 250,000 shares of authorized but unissued Common Stock of the Company were reserved for future issuance under the Plan. This includes up to 40,000 shares for awards to outside directors. The options granted under this plan have an exercise price equal to the fair market value of the common stock on the grant date and vest over a twelve month period. Under this plan, the Company granted 47,700 options in 2006, which included 7,675 options granted to outside directors. The Company adopted a Stock Option Plan for the officers and employees of the Company in 1995. An aggregate of 750,000 shares of authorized but unissued common stock of the Company were reserved for future issuance under the Plan. In 1999, the Company adopted the Directors Stock Compensation Plan with an aggregate of 26,400 shares reserved for issuance under the Plan. The stock options typically have expiration terms of ten years subject to certain extensions and early terminations and vest over periods ranging from six months to one year from the date of grant. The per share exercise price of a stock option shall be, at a minimum, equal to the fair value of a share of common stock on the date the option is granted. There were no options granted under either plan in 2005, as both plans have expired.

As of December 31, 2006, there was approximately \$251,000 of total unrecognized compensation cost related to nonvested options under the plan. For the year ended December 31, 2006, salaries and employee benefits expense includes \$136,000 related to the adoption of Statement No. 123 (R). Net income for 2006 was reduced by approximately \$129,000.

A summary of the Company's stock option activity and related information for the years ended December 31 follows:

	2006			2005		2004	
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	AVERAGE INTRINSIC VALUE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding, beginning of year	140,295	\$ 18.45		149,997	\$ 18.25	148,687	\$ 16.05
Granted	47,700	30.91		--	--	20,475	30.00
Exercised	(4,351)	13.05		(9,701)	15.44	(15,603)	13.14
Forfeited	--	--		--	--	(3,562)	16.16
Outstanding, end of year	183,645	\$ 21.81	\$1,780,000	140,296	\$ 18.45	149,997	\$ 18.25
Exercisable, at end of year	135,945	\$ 18.62	\$1,751,000				

NOTE 12 - STOCK OPTION PLANS (CONTINUED)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Years Ended December 31,		
	2006	2005	2004
Dividend yield	2.70%	--%	2.61%
Expected life	7 years	--	7 years
Expected volatility	25.12%	--%	34.66%
Risk-free interest rate	4.85%	--%	3.80%
Weighted average fair value of options granted	\$8.11	\$--	\$9.50

The expected volatility is based on historical volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical exercise experience. The dividend yield assumption is based on the Company's history and expectation of dividend payouts.

Proceeds from stock option exercises totaled \$60,000 in 2006. Shares issued in connection with stock options exercises are issued from available treasury shares. If no treasury shares are available, new shares are issued from available authorized shares. During 2006, all the shares issued in connection with stock option exercises, 4,351 shares in total, were issued from available treasury shares.

As of December 31, 2006, outstanding stock options consist of the following:

	Options Outstanding	Exercise Price	Remaining Life, Years	Options Exercisable	Exercise Price
	13,695	\$10.88	1.0	13,695	\$10.88
	18,900	15.24	2.0	18,900	15.24
	16,537	14.12	3.0	16,537	14.12
	9,450	10.36	4.0	9,450	10.36
	18,113	16.98	5.0	18,113	16.98
	18,113	19.05	6.0	18,113	19.05
	20,662	23.95	7.0	20,662	23.95
	20,475	30.00	8.0	20,475	30.00
	25,200	30.38	9.3	--	--
	22,500	31.50	10.0	--	--
Outstanding, end of year	183,645	\$21.81	6.0	135,945	\$18.62

NOTE 13 - EARNINGS PER SHARE

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

	YEARS ENDED DECEMBER 31,		
	2006	2005	2004
(IN THOUSANDS, EXCEPT PER SHARE DATA)			
Numerator, net income	\$5,910	\$5,497	\$5,010
Denominator:			
Denominator for basic earnings per share, weighted average shares	2,795	2,800	2,779
Effect of dilutive securities, employee stock options	55	59	59
Denominator for diluted earnings per share, adjusted weighted average shares and assumed conversions	2,850	2,859	2,838
Basic earnings per common share	\$ 2.11	\$ 1.96	\$ 1.80
Diluted earnings per common share	\$ 2.07	\$ 1.92	\$ 1.77

NOTE 14 - OFF-BALANCE-SHEET FINANCIAL INSTRUMENTS

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

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

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

	DECEMBER 31,	
	2006	2005
(IN THOUSANDS)		
Commitments to grant loans	\$12,611	\$16,078
Unfunded commitments under lines of credit	34,152	29,969
Standby letters of credit	7,215	6,791
	\$53,978	\$52,838

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

NOTE 14 - OFF-BALANCE-SHEET FINANCIAL INSTRUMENTS (CONTINUED)

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. 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 Bank requires collateral supporting these letters of credit when deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of December 31, 2006 and 2005 for guarantees under standby letters of credit issued is not material.

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year ends and have not been re-evaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year end.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at December 31, 2006 and 2005:

- o For cash and due from banks and interest-bearing deposits with banks the carrying amount is a reasonable estimate of fair value.
- o For securities, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.
- o The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.
- o The fair value of the investment in FHLB stock is the carrying amount.
- o The fair value of accrued interest receivable and accrued interest payable is the carrying amount.
- o The fair value of demand deposits, savings accounts and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits for similar remaining maturities.
- o The fair value of short-term borrowings approximate their carrying amount.
- o The fair value of long-term debt is estimated using discounted cash flow analyses based upon the Company's current borrowing rates for similar types of borrowing arrangements.
- o The fair value of commitments to extend credit and for outstanding letters of credit is estimated using the fees currently charged to enter into similar agreements.

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The estimated fair values of the Company's financial instruments are as follows:

	DECEMBER 31, 2006		DECEMBER 31, 2005	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
(IN THOUSANDS)				
Financial assets:				
Cash and due from banks and interest-bearing deposits with banks	\$ 9,517	\$ 9,517	\$ 9,816	\$ 9,816
Securities	113,866	113,883	117,266	117,294
Loans receivable, net	311,739	305,779	287,221	282,623
Investment in FHLB stock	1,687	1,687	1,620	1,620
Accrued interest receivable	2,129	2,129	1,812	1,812
Financial liabilities:				
Deposits	358,103	357,691	340,603	340,124
Short-term borrowings	22,736	22,736	18,564	18,564
Long-term debt	13,000	12,974	23,000	23,194
Accrued interest payable	2,894	2,894	1,691	1,691
Off-balance sheet financial instruments:				
Commitments to extend credit and outstanding letters of credit	--	--	--	--

BALANCE SHEETS

	DECEMBER 31,	
	2006	2005
	(IN THOUSANDS)	
ASSETS		
Cash on deposit in bank subsidiary	\$ 552	\$ 989
Securities available for sale	808	753
Investment in bank subsidiary	50,781	46,316
Other assets	731	700
	<u>\$52,872</u>	<u>\$48,758</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities	\$ 641	\$ 650
Stockholders' equity	52,231	48,108
	<u>\$52,872</u>	<u>\$48,758</u>

STATEMENTS OF INCOME

	YEARS ENDED DECEMBER 31,		
	2006	2005	2004
	(IN THOUSANDS)		
Income:			
Dividends from bank subsidiary	\$ 2,369	\$ 1,997	\$ 1,830
Interest income from bank subsidiary	5	16	19
Other interest income	28	26	22
Net realized gain on sales of securities	15	--	--
	<u>2,417</u>	<u>2,039</u>	<u>1,871</u>
Expenses			
	175	198	147
	<u>2,242</u>	<u>1,841</u>	<u>1,724</u>
Income tax expense (benefit)	(43)	(53)	(36)
	<u>2,285</u>	<u>1,894</u>	<u>1,760</u>
Equity in undistributed earnings of subsidiary	3,625	3,603	3,250
	<u>\$ 5,910</u>	<u>\$ 5,497</u>	<u>\$ 5,010</u>

STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,		
	2006	2005	2004
	(IN THOUSANDS)		
Cash Flows from Operating Activities			
Net income	\$ 5,910	\$ 5,497	\$ 5,010
Adjustments to reconcile net income to net cash provided by operating activities:			
Undistributed earnings of bank subsidiary	(3,625)	(3,603)	(3,250)
Release of ESOP shares	421	565	585
Other, net	(131)	(615)	(40)
Net Cash Provided by Operating Activities	<u>2,575</u>	<u>1,844</u>	<u>2,305</u>
Cash Flows from Investing Activities			
Proceeds from sale of securities	30	--	--
Purchase of securities available for sale	(43)	(52)	(125)
Net Cash Used in Investing Activities	<u>(13)</u>	<u>(52)</u>	<u>(125)</u>
Cash Flows from Financing Activities			
Stock options exercised	60	150	206
ESOP purchase of shares from treasury stock	120	114	77
Acquisition of treasury stock	(890)	(819)	(118)
Cash dividends paid	(2,289)	(1,916)	(1,795)
Net Cash Used in Financing Activities	<u>(2,999)</u>	<u>(2,471)</u>	<u>(1,630)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>(437)</u>	<u>(679)</u>	<u>550</u>
Cash and Cash Equivalents - Beginning	989	1,668	1,118
Cash and Cash Equivalents - Ending	<u>\$ 552</u>	<u>\$ 989</u>	<u>\$ 1,668</u>

INVESTOR INFORMATION

STOCK LISTING

Norwood Financial Corp. stock is traded on the Nasdaq Market under the symbol NWFL. The following firms are known to make a market in the Company's stock:

FERRIS BAKER WATTS
Baltimore, MD
410-659-4616

F.J. MORRISSEY & CO, INC.
West Conshohocken, PA
800-842-8928

LEGG MASON WOOD WALKER, INC.
Scranton, PA 18507
570-346-9300

JANNEY MONTGOMERY SCOTT, LLC
Scranton, PA 18503
800-638-4417

RYAN BECK & CO.
Livingston, NJ
800-395-7926

BOENNING & SCATTERGOOD, INC.
West Conshohocken, PA
800-496-1170

TRANSFER AGENT

Illinois Stock Transfer Company, 209 West Jackson Blvd., Suite 903, Chicago, IL 60606. Stockholders who may have questions regarding their stock ownership should contact the Transfer Agent at 312-427-2953.

DIVIDEND CALENDAR

Dividends on Norwood Financial Corp. common stock, if approved by the Board of Directors are customarily paid on or about February 1, May 1, August 1 and November 1.

AUTOMATIC DIVIDEND REINVESTMENT PLAN

The Plan, open to all shareholders, provides the opportunity to have dividends automatically reinvested into Norwood stock. Participants in the Plan may also elect to make cash contributions to purchase additional shares of common stock. Shareholders do not incur brokerage commissions for the transactions. Please contact the transfer agent or Lewis J. Critelli for additional information.

SEC REPORTS AND ADDITIONAL INFORMATION

A copy of the Company's report on Form 10-K for its fiscal year ended December 31, 2006 including financial statements and schedules thereto, required to be filed with the Securities and Exchange Commission may be obtained upon written request of any stockholder, investor or analyst by contacting Lewis J. Critelli, Executive Vice President and Chief Financial Officer, Norwood Financial Corp., 717 Main Street, PO Box 269, Honesdale, PA 18431, 570-253-1455.

[GRAPHIC OMITTED]
Main Street Parade - 1899

Lower Main Street during a Flag Day Parade, 1899. Note Wayne County Savings Bank across the street.

DIRECTORY OF OFFICERS

NORWOOD FINANCIAL CORP.

Russell L. Ridd	Chairman of the Board	Kelly J. Lalley	Assistant Vice President & Assistant Secretary
William W. Davis, Jr.	President & Chief Executive Officer	Laurie J. Bishop	Assistant Community Office Manager
Lewis J. Critelli	Executive Vice President & Chief Financial Officer	Renee M. Gilbert	Community Office Manager
Edward C. Kasper	Senior Vice President	Marianne M. Glamann	Community Office Manager
John H. Sanders	Senior Vice President	Teresa Melucci	Community Office Manager
Joseph A. Kneller	Senior Vice President	Sandra Mruczkewycz	Community Office Manager
John E. Marshall	Secretary	Sandra Halas	Wealth Management Investment Manager

WAYNE BANK

Russell L. Ridd	Chairman of the Board	Gary D. Henry	Consumer Lending Officer
William W. Davis, Jr.	President & Chief Executive Officer	Annette A. Jurkowski	Wealth Management Operations Manager
Lewis J. Critelli	Executive Vice President & Chief Financial Officer	Thomas Kowalski	Resource Recovery Manager
Edward C. Kasper	Senior Vice President & Senior Loan Officer/ Corporate Bank	Jill Melody	Assistant Community Office Manager
John H. Sanders	Senior Vice President/Retail Bank	Linda M. Moran	Marketing Officer
Joseph A. Kneller	Senior Vice President	William E. Murray	Mortgage Originator
Wayne D. Wilcha	Senior Vice President & Trust Officer	Sarah J. Rapp	Human Resources Officer
John E. Marshall	Secretary	Diane L. Richter	Assistant Community Office Manager
Robert J. Behrens, Jr.	Vice President	Toni M. Stenger	Assistant Community Office Manager
John F. Carmody	Vice President	Doreen A. Swingle	Residential Mortgage Lending Officer
JoAnn Fuller	Vice President	Karen Vashlishan	Compliance Officer
Carolyn K. Gwozdziejewycz	Vice President	Karen Verbeke	Community Office Manager
Nancy A. Hart	Vice President	Nancy M. Worobey	Community Office Manager

NORWOOD INVESTMENT CORP

Nancy A. Hart	Vice President, Controller & Assistant Secretary	William W. Davis, Jr.	President & Chief Executive Officer
Raymond C. Hebden	Vice President	Lewis J. Critelli	Executive Vice President
William J. Henigan, Jr.	Vice President	Scott C. Rickard	Investment Representative, Invest Financial Corp.
William R. Kerstetter	Vice President	Amy E. Kasper	Investment Representative, Invest Financial Corp.

MONROE COUNTY ASSOCIATE BOARD

Barabara A. Ridd	Vice President & Assistant Secretary	Michael J. Baxter	James H. Ott
Jeffrey R. Shrader	Vice President	Sara Cramer	Ron Sarajian
Eli T. Tomlinson	Vice President	Andrew Forte	Ray Price
Jennifer M. Witowic	Vice President	Ralph A. Matergia, Esq.	Marvin Papillon
Karen R. Gasper	Internal Auditor & Assistant Vice President	Randy R. Motts	
Norma J. Kuta	Assistant Vice President		

[GRAPHIC OMITTED]

We would like to thank Gloria McCullough and the Wayne County Historical Society for providing these photographs and their provenance. Wayne Bank very much appreciates this kindness and generosity.

visit us: www.waynebank.com

Consent of Independent Registered Public Accounting Firm

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No.'s 333-61487 and 333-134831) of Norwood Financial Corp. of our report dated February 26, 2007, relating to the consolidated financial statements, which appears in the Annual Report to Stockholders, which is incorporated by reference in this Annual Report on Form 10-K.

/s/ Beard Miller Company LLP

Beard Miller Company LLP
Reading, Pennsylvania
March 21, 2007

CERTIFICATION

I, William W. Davis, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of Norwood Financial Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 22, 2007

/s/ William W. Davis, Jr.

William W. Davis, Jr.
President and Chief Executive Officer

CERTIFICATION

I, Lewis J. Critelli, certify that:

1. I have reviewed this annual report on Form 10-K of Norwood Financial Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 22, 2007

/s/ Lewis J. Critelli

Lewis J. Critelli

Executive Vice President and Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Norwood Financial Corp. (the Company) on Form 10-K for the period ending December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the Report), we, William W. Davis, Jr., President and Chief Executive Officer, and Lewis J. Critelli, Executive Vice President and Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ William W. Davis, Jr.

William W. Davis, Jr.
President and Chief Executive Officer

/s/ Lewis J. Critelli

Lewis J. Critelli
Executive Vice President and Chief
Financial Officer

March 22, 2007

Date