

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarter period ended June 30, 1997

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-28366

Norwood Financial Corp.

(Exact name of registrant as specified in its charter)

Pennsylvania

23-2828306

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. employer  
identification no.)

717 Main Street  
Honesdale, Pennsylvania 18431

(Address of principal executive offices)  
(Zip Code)

Registrant's telephone number, including area code: (717) 253-1455

N/A

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

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

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of  
common stock, as of the latest practicable date.

Class

Outstanding as of July 31, 1997  
830,475 shares

Common stock, par value \$0.10 per share

NORWOOD FINANCIAL CORP.  
FORM 10-Q  
FOR THE QUARTER ENDED JUNE 30, 1997  
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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

-----  
NORWOOD FINANCIAL CORP.

Consolidated Balance Sheets (unaudited)

(dollars in thousands)

	June 30, 1997	December 31, 1996
	-----	-----
<b>ASSETS</b>		
Cash and due from banks	\$ 8,996	\$ 7,072
Interest bearing deposits with banks	1,103	1,187
Federal funds sold	2,500	6,850
Investment securities available for sale	43,849	48,906
Investment securities (fair value of \$9,130 and \$9,040)	8,807	8,805
Loans and leases (net of unearned income)	185,591	174,554
Less: Allowance for loan and lease losses	2,940	2,616
	-----	-----
Net loans and leases	182,651	171,938
Bank premises and equipment, net	7,895	7,779
Other real estate	1,026	2,283
Accrued interest receivable	1,361	1,558
Other assets	4,010	3,707
	-----	-----
<b>TOTAL ASSETS</b>	<b>\$ 262,198</b>	<b>\$ 260,085</b>
	=====	=====
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing demand	\$ 26,399	\$ 25,256
Interest-bearing deposits	194,055	204,073
	-----	-----
Total deposits	220,454	229,329
Short-term borrowings	12,026	3,227
Other borrowed funds	2,451	2,442
Accrued interest payable	1,823	2,224
Other liabilities	2,773	1,344
	-----	-----
<b>TOTAL LIABILITIES</b>	<b>239,527</b>	<b>238,566</b>
	-----	-----
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$.10 par value, authorized 10,000,000 shares issued 900,796 and outstanding 889,566 shares	90	90
Surplus	4,448	4,444
Retained earnings	19,713	18,861
Treasury stock, at cost (11,230 shares)	(345)	(345)
Unearned ESOP shares	(1,850)	(1,950)
Net unrealized gain on securities	615	419
	-----	-----
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>22,671</b>	<b>21,519</b>
	-----	-----
<b>TOTAL LIABILITIES AND     STOCKHOLDERS' EQUITY</b>	<b>\$ 262,198</b>	<b>\$ 260,085</b>
	=====	=====

[FN]

See accompanying notes to the unaudited consolidated financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	1997	1996	1997	1996
	-----		-----	
<b>INTEREST INCOME</b>				
Interest and fees on loans and leases	\$ 4,040	\$ 3,584	\$ 7,911	\$ 7,096
Investment securities	905	889	1,829	1,695
Federal funds sold and deposits with banks	36	75	81	99
	-----		-----	
Total interest income	4,981	4,548	9,821	8,890
	-----		-----	
<b>INTEREST EXPENSE</b>				
Deposits	2,012	1,888	4,071	3,683
Short-term borrowings	139	36	190	152
Other borrowed funds	56	55	110	109
	-----		-----	
Total interest expense	2,207	1,979	4,371	3,944
	-----		-----	
INTEREST INCOME	2,774	2,569	5,450	4,946
PROVISION FOR LOAN LOSSES	300	200	550	350
	-----		-----	
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	2,474	2,369	4,900	4,596
	-----		-----	
<b>OTHER INCOME</b>				
Service charges and fees	112	108	284	235
Trust department income	38	29	85	80
Investment securities gains/(losses)	62	-	62	-
Other	164	157	220	199
	-----		-----	
Total other income	376	294	651	514
	-----		-----	
<b>OTHER EXPENSES</b>				
Salaries and benefits	905	968	1,852	1,867
Occupancy, furniture & equipment, net	308	274	622	539
Shares tax	61	55	120	109
Other real estate owned operations	123	131	168	158
Other	588	601	1,191	1,094
	-----		-----	
Total other expenses	1,985	2,029	3,953	3,767
	-----		-----	
INCOME BEFORE TAX	865	634	1,598	1,343
INCOME TAXES	221	131	397	302
	-----		-----	
NET INCOME	\$ 644	\$ 503	\$ 1,201	\$ 1,041
	=====	=====	=====	=====
<b>EARNINGS PER SHARE</b>				
	\$ 0.78	\$ 0.58	\$ 1.45	\$ 1.20
	=====	=====	=====	=====
Dividends per share	\$ 0.21	\$ 0.21	\$ 0.42	\$ 0.42
	=====	=====	=====	=====
Average shares outstanding	830,475	871,540	830,475	873,027

[FN]  
See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.  
 Consolidated Statement of Changes in Stockholders' Equity (unaudited)  
 (dollars in thousands)

	Common Stock	Surplus	Retained Earnings	Treasury Stock	Unearned ESOP Shares	Net Unrealized Gain on Securities	Total
	-----	-----	-----	-----	-----	-----	-----
Balance, December 31, 1996	\$ 90	\$ 4,444	\$ 18,861	\$ (345)	\$ (1,950)	\$ 419	\$ 21,519
Net Income			1,201				1,201
Cash dividend declared			(349)				(349)
Net unrealized gain/(loss) on securities						196	196
Release of earned ESOP shares		4			100		104
	-----	-----	-----	-----	-----	-----	-----
Balance, June 30, 1997	<u>\$ 90</u>	<u>\$ 4,448</u>	<u>\$ 19,713</u>	<u>\$ (345)</u>	<u>\$ (1,850)</u>	<u>\$ 615</u>	<u>\$ 22,671</u>

[FN]  
 See accompanying notes to the unaudited consolidated financial statements.

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

	Six Months Ended June 30,	
	1997	1996
	-----	-----
<b>OPERATING ACTIVITIES</b>		
Net Income	\$ 1,201	\$ 1,041
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	550	350
Depreciation and amortization	477	296
Net amortization of investment securities	5	3
Investment security gains, net	(62)	-
Loss on sale of other real estate, net	58	64
Proceeds from sales of loans	3,007	85
Increase in core deposit intangible, net	-	(1,744)
Decrease (increase) in accrued interest receivable	197	(41)
Increase (decrease) in accrued interest payable	(401)	(119)
Increase (decrease) in accrued taxes	532	(277)
Other, net	660	93
	-----	-----
Net cash provided by (used for) operating activities	6,224	(249)
	-----	-----
<b>INVESTING ACTIVITIES</b>		
Investment securities available for sale:		
Proceeds from sales of investment securities	5,980	502
Proceeds from maturities of investment securities	1,523	11,234
Purchases of investment securities	(2,156)	(21,623)
Investment securities:		
Proceeds from maturities of investment securities	-	3,140
Purchases of investment securities	-	-
Net increase in loans	(14,579)	(6,918)
Purchase of premises and equipment, net	(450)	(882)
Proceeds from sales of other real estate	1,377	395
	-----	-----
Net cash (used for) investing activities	(8,305)	(14,152)
	-----	-----
<b>FINANCING ACTIVITIES</b>		
Increase (decrease) in deposits, net	(8,875)	18,545
Net increase in borrowings	8,798	2,429
Purchase of treasury stock	-	(320)
Issuance of common stock	-	12
Cash dividends paid	(352)	(359)
	-----	-----
Net cash provided by (used for) financing activities	(429)	20,307
	-----	-----
Increase (decrease) in cash and cash equivalent	(2,510)	5,906
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	15,109	6,447
	-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 12,599	\$ 12,353
	=====	=====

[FN]

See accompanying notes to the unaudited consolidated financial statements.

## Notes to Unaudited Consolidated Financial Statements

### Basis of Presentation

The consolidated financial statements include the accounts of Norwood Financial Corp. (Company) and its wholly-owned subsidiary, Wayne Bank (Bank) and the Bank's wholly-owned subsidiaries, WCB Realty Corp. and Norwood Investment Corp. All significant intercompany transactions have been eliminated in consolidation. The investments in subsidiaries on the Company's financial statements are carried at the Company's equity in the underlying net assets.

The financial statements have been prepared in conformity with generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. The financial statements reflect, in the opinion of management, all normal, recurring adjustments necessary to present fairly the financial position of the Company. The operating results for the three month and six month period ended June 30, 1997 are not necessarily indicative of the results that may be expected for the period ended December 31, 1997 or any other period.

For additional information and disclosure required under generally accepted accounting principals, reference is made to the Company's 1996 Annual Report filed on Form 10-K (File No. 0-28366).

### Earnings Per Share

Earnings per share computations are based on the weighted average number of shares outstanding which was 830,475 and 871,540 for the three month periods ending June 30, 1997 and June 30, 1996 respectively. For the six month period June 30, 1997 and 1996 average shares outstanding were 830,475 and 873,027, respectively.

### Cash Flow Information

For the purposes of reporting cash flows, cash and cash equivalents include cash and due from banks and federal funds sold.

Cash payments for interest for the six month period ended June 30, 1997 and 1996 were \$4,472,584 and \$4,063,481 respectively. There were no cash payments for income taxes in 1997 compared to \$569,544 in 1996. Non-cash investing activity for 1997 and 1996 include foreclosed mortgage loans transferred to real estate owned of \$209,995 and \$1,146,810, respectively.

### Reclassification of Comparative Amounts

Certain comparative amounts for prior years have been reclassified to conform to current year presentation. Such reclassifications did not affect net income.

## Pending Accounting Pronouncements

In June 1996, the Financial Accounting Standards Board (FASB) issued Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings based on control-oriented "financial-components" approach. Under this approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and liabilities it has incurred, derecognizes financial assets when control has been surrendered and derecognizes liabilities when extinguished. The provisions of Statement No. 125 are effective for transactions occurring after December 31, 1996, except those provisions relating to repurchase agreements, securities lending, and other similar transactions and pledged collateral, which have been delayed until after December 31, 1997 by Statement No. 127, "Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125, an amendment of FASB Statement No. 125." The adoption of these statements is not expected to have a material impact on financial position or results of operations.

On March 3, 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 128, "Earnings Per Share." Statement No. 128 will become effective for the Corporation beginning in 1998. This statement re-defines the standards for computing earnings per share (EPS) previously found in Accounting Principles Board Opinion No. 15, Earnings Per Share. Statement No. 128 establishes new standards for computing and presenting EPS and requires dual presentation of "basic" and "diluted" EPS on the face of the income statement for all entities with complex capital structures. Under Statement No. 128, basic EPS is to be computed based upon income availability to common shareholders and the weighted average number of common shares outstanding for the period. Diluted EPS is to reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Corporation. Statement No. 128 also requires the restatement of all prior-period EPS data presented. The Corporation will adopt Statement No. 128 on January 1, 1998 and based on current estimates, does not believe the effect of adoption will have a significant impact on the Corporation's financial position or results of operations.

In July 1997, the Financial Accounting Standards Board issued statement of Financial Accounting Standard No. 130, "Reporting Comprehensive Income." Statement No. 130 establishes standards for reporting and presentation of comprehensive income and its components (revenues, expenses, gains, and losses) in a full set of general-purpose financial statements. It requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is presented with the same prominence as other financial statements. SFAS No. 130 requires that companies (i) classify items of other comprehensive income by their nature in a financial statement and (ii) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the statement of financial condition. SFAS No. 130 is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comprehensive purposes is required.

## Employee Benefit Plans

### Employee Stock Ownership Plan (ESOP)

On August 27, 1996, the Board of Directors approved the creation of 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 Company 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 sheet. 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; dividends on unallocated ESOP shares are recorded as a reduction of debt.

Defined Benefit Pension Plan

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On February 11, 1997, the Company decided to discontinue to provide benefits under the defined benefit plan. The Company on August 1, 1997 received final IRS approval to terminate the plan and will settle obligations under the defined benefit plan during the third quarter of 1997. The effects of the settlement cannot be determined at this time.

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

-----  
Financial Condition  
-----

General  
-----

Total assets at June 30, 1997, were \$262.2 million, increasing \$2.1 million from \$260.1 million at December 31, 1996. The increase was principally due to \$11.0 million of loan growth which was funded by cash flow from the investment portfolio, lower level of Federal Funds sold and increase in stockholders' equity. A decrease in time deposits over \$100,000, of \$13.1 million, primarily school district deposits and other public funds, was offset by \$6 million increased borrowings from the Federal Home Loan Bank, and growth in core deposits.

Investments  
-----

The fair value of investment securities available for sale was \$43.8 million at June 30, 1997, decreasing from \$48.9 million at December 31, 1996. The decrease was principally due to sales of \$5.8 million of securities. The Company took advantage of bond market conditions in June to sell certain longer-term securities. The proceeds were used to fund loan growth and invested in shorter-term instruments. The held-to-maturity portfolio which consists of longer-term municipals, at \$8.8 million showed no change from December 31. The fair market value of securities held to maturity at June 30, 1997 is \$9,130,000 compared to book value of \$8,807,000.

Loans and Leases  
-----

Total loans and leases were \$185.6 million at June 30, 1997, an increase of \$11 million or 6.3% from year-end 1996. The growth was principally attributable to indirect financing and automobile leasing. Indirect financing which includes new and used automobile and marine lending increased \$3.9 million to total \$28.7 million at June 30, 1997. Auto leasing portfolio totaled \$28.4 million at June 30, 1997, increasing \$11.4 million from year-end 1996. The indirect and auto leasing volume is originated through a network of over 40 dealers geographically disbursed throughout Northeastern Pennsylvania and has an average term of less than 50 months. Commercial loans increased \$1.5 million from year-end. Residential mortgages decreased \$2.2 million principally as a result of pay downs in adjustable rate mortgages. The Company sells the majority of its fixed rate residential mortgages in the secondary market with sales totaling \$1.5 million during 1997. The Company sold its student loan portfolio of \$1.5 million to Sallie Mae. The Company will originate student loans through Sallie Mae, on a fee basis, and not hold the loans in portfolio.

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

Types of loans and leases  
(dollars in thousands)

	June 30, 1997		December 31, 1996	
	\$	%	\$	%
Commercial, financial and agricultural	\$ 30,839	16.4%	\$ 29,679	16.8%
Real estate-construction	2,186	1.2	1,602	0.9
Real estate-mortgage	88,231	46.9	91,401	51.5
Leases to individuals (net of unearned)	28,373	15.1	16,981	9.6
Installment loans to individuals	38,392	20.4	37,502	21.2
<b>Total loans and leases</b>	<b>188,021</b>	<b>100.0%</b>	<b>177,165</b>	<b>100.0%</b>
Less: Unearned income	2,430		2,611	
<b>Total loans and leases, net of unearned</b>	<b>\$185,591</b>		<b>\$174,554</b>	

Allowance for Loan Losses and Non-performing Assets

Following is a summary of changes in the allowance for loan losses for the periods indicated:

(dollars in thousands)	At or for the Three Months Ended June 30,		At or for the Six Months Ended June 30,	
	1997	1996	1997	1996
Balance at beginning of period	\$ 2,740	\$ 2,097	\$ 2,616	\$ 2,125
Provision for loan losses	300	200	550	350
Charge-offs	(150)	(208)	(299)	(418)
Recoveries	50	44	73	76
Net charge-offs	(100)	(164)	(226)	(342)
Balance at end of period	<b>\$ 2,940</b>	<b>\$ 2,133</b>	<b>\$ 2,940</b>	<b>\$ 2,133</b>
Allowance to total loans and leases	1.58%	1.36%	1.58%	1.36%
Net charge-offs to average loans (annualized)	.22%	.43%	.25%	.45%

The allowance for loan losses totaled \$2,940,000 at June 30, 1997 and represented 1.58% of total loans, increasing from \$2,615,000 and 1.50% at year-end, and \$2,133,000 and 1.36% at June 30, 1996. The provision for loan

losses for the current year was \$550,000, compared to \$350,000 for 1996. The Bank's loan review function 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 a credit review and gives consideration to areas of exposure such as concentration of credit, economic and industry conditions, trends in delinquencies, collections and collateral value coverage. General reserve percentages are identified by loan type and credit grading and allocated accordingly. Larger credit exposures are individually analyzed. Management considers the allowance adequate at June 30, 1997. While the allowance for loan losses as a percentage of total loans is comparable to peer group, prudence dictates it should be increased going forward given the current level of non-performing loans. As a result, the Company may continue to incur provisions to obtain the appropriate level.

At June 30, 1997, the recorded investment in loans which are considered to be impaired in accordance with Statement of Financial Accounting Standards Nos. 114 and 118 was \$2,592,877. This was comprised of \$414,738 with related allowance of \$25,257 and loans of \$2,178,139 with no related allowance for loan losses. Impaired loans are commercial and commercial real estate loans for which it is probable that the company will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Company estimates credit losses on impaired loans based on present value of expected cash flows or the fair value of the underlying collateral if loan repayment is expected to come from sale of operations of such collateral.

At June 30, 1997, non-performing loans totaled \$2,927,000 which is 1.56% of total loans decreasing from \$3,493,000, or 1.98% of total loans at December 31, 1996. The following table sets forth information regarding non-performing loans and other real estate owned at the date indicated:

(dollars in thousands)	June 30, 1997 -----	December 31, 1996 -----
Non-accrual loans:		
Commercial and all other	\$ 1,423	\$ 1,633
Real estate	1,450	1,790
Consumer	12	28
	-----	-----
Total	2,885	3,451
Loans accruing which are past due 90 days or more	42	42
	-----	-----
Total non-performing loans	2,927	3,493
Other real estate owned	1,026	2,283
	-----	-----
Total non-performing assets	\$3,953	\$5,776
	=====	=====
Allowance for loan losses as a percent of non-performing loans	100.4%	74.9%
Non-performing loans to total loans	1.58%	1.98%
Non-performing assets to total assets	1.51%	2.22%

Other real estate owned total \$1,026,000 at June 30, 1997, decreasing principally due to sales, from \$2,283,000 at December 31. The largest non-performing loan relationship is \$1,050,000 and consists of the real estate and inventory of a marina. The Company is in the process of an orderly liquidation of the inventory and is aggressively marketing the real estate.

#### Deposits

-----

Total deposits at June 30, 1997, were \$220.5 million, a decrease of \$8.9 million from December 31, 1996. The decrease was principally due to lower level of time deposits greater than \$100,000 consisting primarily of school district deposits and other public funds. Non-interest bearing demand deposits totaled \$26.4 million at June 30, 1997 representing 12% of total deposits compared to \$25.2 million and 11% at year-end. A new tiered rate money market account, introduced in June, totaled \$2.5 million at June 30, 1997 with over 50% new funds.

#### Short-term Borrowings

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Short-term borrowings at June 30, 1997 totaled \$12,026,000, increasing from \$3,227,000 at December 31, 1996. The increase is principally due to \$6 million borrowing from the Federal Home Loan Bank with original term of three months maturing on July 23, 1997. Corporate cash management accounts and repurchase agreement were \$5,025,000 at June 30, 1997 compared to \$2,604,000 at December 31, 1996.

#### Stockholders' Equity and Capital Ratios

-----

Total stockholders' equity at June 30, 1997, was \$22,671,000 compared to \$21,519,000 at December 31, 1996. A comparison of capital ratios is as follows:

	June 30, 1997	December 31, 1996
	-----	-----
Leverage	7.9%	7.7%
Tier 1 Capital	10.4%	10.3%
Total Capital	11.6%	11.5%

The minimum capital requirements imposed by the FDIC for leverage, Tier 1 and Total Capital are 4%, 4% and 8%, respectively. The Bank is also subject to more stringent Pennsylvania Department of Banking (PDB) guidelines. Although not adopted in regulation form, the PDB utilizes capital standards requiring a minimum of 6.5% leverage capital and 10% total capital. The Company and the Bank were in compliance in both FDIC and PDB capital requirements at June 30, 1997 and December 31, 1996.

## Liquidity and Interest Rate Sensitivity

-----

Maintenance of liquidity is coordinated by the Asset/Liability Committee (ALCO). Liquidity Policy is established by the Board of Directors with certain key ratios used to measure liquidity. The Company's liquidity can be viewed as the ability to fund customers borrowing needs and their deposit withdrawal requests while supporting asset growth. Primary sources of liquidity include deposit generation, borrowings available from other financial institutions, asset maturities and cash flows from loan repayments and investments.

The Company maintains established lines of credit with the Federal Home Loan Bank of Pittsburgh (FHLB) and other correspondents. At June 30, 1997 the maximum borrowing capacity with the FHLB was \$48,371,000 with \$6,000,000 repurchase agreement outstanding at June 30, 1997 compared to no outstandings at December 31, 1996.

During the six months ended June 30, 1997, the Company substituted short-term borrowings, which increased \$8.8 million, for public fund time deposits which decreased \$12.4 million. Core deposits including savings and transactions accounts increased \$3.4 million during the period. Sources of liquidity are also available in the investment portfolio. The Company did sell \$5.8 million of securities during the second quarter, with part of the proceeds used to fund loan growth. Scheduled maturities, anticipated repayments and projected calls total \$16 million over the next twelve months. Cash flow is also provided by scheduled pay downs in the loan portfolio. The Company believes its liquidity position is adequate at June 30, 1997.

Interest rate sensitivity and the repricing characteristics of assets and liabilities are managed by 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 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 affected by interest rate movements. To manage the impact of the rate changes, the balance sheet must be structured so that repricing opportunities exist for both assets and liabilities at approximately the same time intervals. ALCO monitors these repricing characteristics and identifies strategies, including management of liability costs and maturities, structure of the investment portfolio, and various lending activities to insulate net interest income from the effects of changes in interest rates. The Company employs net interest simulation modeling to assist in interest rate risk management. The process includes simulating various interest rate environments and their impact on net interest income. At June 30, 1997, the level of net interest income at risk in a 200 basis points increase or decrease was within policy limits.

Imbalance in repricing opportunities at a given point in time reflect interest-sensitivity gaps - the difference between interest-sensitive assets

and interest-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 June 30, 1997, the Company had a positive 30 day positive gap position of \$14,036,000. A positive gap means interest-sensitive assets are higher than interest-sensitive liabilities at the time interval. This would indicate that in a declining rate environment, the yield on earning assets would decrease faster than the cost of interest-bearing liabilities in the 30 day time frame. This risk is managed by ALCO strategies, including investment portfolio structure, pricing of deposit liabilities, loan pricing and structure of fixed and variable rate products.

The Company analyzes and measures the time periods in which interest-earning assets and interest-bearing liabilities will mature or reprice in accordance with their contractual terms. Management believes that the assumptions used to evaluate the vulnerability of the Company's operations to changes in interest rates are reasonable. The interest rate sensitivity of the Company's 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. 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.

Results of Operation  
- - - - -

Comparison of Operating Results for Six Months Ended June 30, 1997 and 1996  
- - - - -

General  
- - - - -

For the six months of 1997 net income totaled \$1,201,000 or \$1.45 earnings per share compared to \$1,041,000 or \$1.20 earnings per share for the prior year. Return on average assets and return on average equity for the period were .93% and 10.93% respectively, improving from .90% and 9.14% respectively in 1996.

Net Interest Income  
- - - - -

Net interest income, on a fully taxable equivalent basis (FTE) for the six months of 1997 was \$5,647,000, an increase of \$477,000, or 9.2%, over 1996. The resultant FTE net interest spread and net interest margin for 1997 were 4.12% and 4.69%, respectively, compared to 4.30% and 4.87%, respectively, in 1996. The decrease in net interest margin was principally the result of lower earning asset yields, 8.32% in 1997 declining 26 basis points from 8.58% in 1996.

Interest income on an FTE basis totaled \$10,018,000 for the period, an increase of \$903,000. The increase was due to \$28.4 million growth in average earning assets. The yield on investment securities; held-to-maturity and available-for-sale, increased 40 basis points and 6 basis points, respectively from 1996. The yield on the loan portfolio for the period of 1997 was 8.81%, compared to 9.26%. The decline in yield was due to change in the mix of the loan portfolio. On average, loans and leases increased \$26.4 million, or 17.2%. The increase consisted principally of growth in lower yielding indirect automobile lending \$11.7 million and automobile leasing \$22.4 million, offset by lower levels of higher yielding commercial and real estate loans. The income earned on the loan portfolio, was \$7,915,000 increasing from \$7,100,000 in 1996.

Total interest expense for the current period was \$4,371,000 compared to \$3,944,000 in 1996, for a resulting cost of interest-bearing liabilities of 4.20%, decreasing from 4.28% in the first six months of 1996. On average the Company funded its growth in earning assets principally from deposit growth. Average interest bearing deposits increased \$22.6 million of which \$10.1 million represents deposits purchased from Meridian Bank in March 1996. The costs of deposits declined 8 basis points to 4.11%, with decreases in all categories. The mix of deposits become more expensive with time deposits representing 55% increasing from 50% of interest-bearing deposits.

#### Non-interest Income

- - - - -

Non-interest income for six months of 1997 totaled \$651,000. This includes \$62,000 in investment securities gains principally related to sale of an equity holding in another financial institution. Excluding this gain, non-interest income is \$589,000 compared to \$514,000 in 1996, an increase of \$75,000, or 14.6%. Service charges and fees increased \$45,000 to \$284,000 principally due to \$33,000 of ATM surcharge fee income. Commissions on sales of annuities and mutual funds through Norwood Investment Corp. were \$33,000 for the six months. Other increases in fee income include debit card introduced in April 1997 and improvements in merchant card processing.

#### Non-interest Expense

- - - - -

Non-interest expense totaled \$3,953,000 for six months 1997 compared to \$3,767,000 in 1996, an increase of \$186,000 or 4.9%. The increase was principally due to full six month effect of three branches acquired from Meridian Bank in March 1996 of \$151,000 and expenses of \$73,000 related to increased auto leasing volume. Total salary and benefits were \$1,852,000 compared to \$1,867,000, with full-time equivalents of 117 at June 30, 1997, decreasing from 124 at June 30, 1996. The Company incurred FDIC assessment costs of \$13,746 compared to \$1,000 in 1996, with increase due to the assessment related to Financing Corp. (FICO) bond obligation as required by the Deposit Insurance Funds Act of 1996 (DIFA). The company continues to have expenses related to other real estate owned operations (OREO) which includes loss on sale, write-downs to realizable value and legal fees related to resolving non-performing assets. For the six months of 1997, OREO costs were \$168,000 compared to \$158,000 the prior year, with additional legal fees of \$89,000, increasing from \$74,000 in 1996. The Company reduced certain

expenditures during the six months including marketing costs by \$45,000; supply expenses by \$20,000 as a result of outsourcing the purchasing; and consulting/training fees by \$53,000 with costs related to technology, sales training and human resources incurred in 1996. The efficiency ratio for six months improved to 62.7% from 66.3% in 1996.

#### Income Tax Expense

Income taxes for the period total \$397,000 for an effective tax rate of 24.8% compared to \$302,000 and 22.5% in 1996. The increase in the effective rate is principally due to a lower level of tax exempt securities and higher amount of pre-tax income in 1997.

#### Comparison of Operating Results for Three Months Ended June 30, 1997 and June 30, 1996

##### General

For the three months ended June 30, 1997, net income was \$644,000 and increase of \$141,000 or 28% from \$503,000 earned for the second quarter of 1996. Earnings per share for 1997 period were \$.78 compared to \$.58 in 1996. Resultant return on assets and return on equity for second quarter of 1997 were .99% and 11.75% respectively, improving from .84% and 8.84% respectively, in 1996.

##### Net Interest Income

Interest income on an FTE basis totaled \$5,077,000, an increase of \$408,000 or 8.7% from 1996 period. The increase was principally due to higher level of earning assets in 1997. The yield on loans was 8.85% decreasing from 9.27% in 1996, primarily due to change in loan mix to lower yielding indirect lending and auto leasing. The total yield on earning assets was 8.35% in 1997, a decrease of 21 basis points from 1996.

Total interest expense for 1997 second quarter was \$2,207,000 compared to \$1,979,000 in 1996, an increase of 11.5%. The total cost of funds in 1997 was 4.23% compared to 4.17% in 1996. The increase was principally due to more expensive deposit mix with higher level of certificates of deposit.

With a decrease in earning asset yield and increase in cost of funds, the net interest spread for three months 1997 decreased to 4.14% from 4.38% in 1996, and net interest margin 4.73% down from 4.95% in 1996. However, with growth in earning assets, net interest income on an FTE basis increased \$180,000 or 6.7%, to \$2,870,000.

##### Non-Interest Income

Non-interest income totaled \$376,000 for the second quarter of 1997 which

included \$62,000 gain on sales of securities. Excluding the gain on sale investment securities non-interest income was \$314,000, an increase of \$18,000 over second quarter of 1996. The increase was principally due to ATM surcharge income, trust fees and fees associated debit card and merchant card processing.

#### Non-Interest Expense

- - - - -

Non-interest expense of \$1,985,000 for the 1997 period, decreased \$44,000 or 2.2% from 1996. Salary and benefit costs decreased 6.5% due to lower staffing levels. Costs associated with OREO totaled \$123,000 for the period, down from \$131,000 in 1996. Efficiency ratio for the quarter was 62.3% improving from 68.3% in 1996.

#### Income Taxes

- - - - -

Income taxes totaled \$221,000 for the quarter for an effective tax rate of 25.6% compared to \$131,000 and 20.7% in 1996. The increase in effective rate is principally due to lower level of tax-exempt income and higher per-tax income.

NORWOOD FINANCIAL CORP.  
Consolidated Average Balance Sheets with Resultant Interest and Rates  
(Tax-Equivalent Basis, dollars in thousands)

	Six Months Ended June 30,					
	1997			1996		
	Average Balance (2)	Interest (1) (Tax equivalent basis, dollars in thousands)	Average Rate	Average Balance (2)	Interest (1)	Average Rate
<b>Assets</b>						
Interest-earning assets:						
Federal funds sold	\$ 2,043	\$ 57	5.58%	\$ 3,380	\$ 88	5.21%
Interest bearing deposits with banks	878	24	5.47	442	11	4.98
Investment securities	8,806	375	8.52	11,767	478	8.12
Investment securities available for sale:						
Taxable investments	44,457	1,452	6.53	39,322	1,267	6.44
Tax-exempt securities	4,917	195	7.93	4,167	170	8.16
Total investment securities available for sale	49,374	1,647	6.67	43,489	1,437	6.61
Loans and leases (3) (4)	179,747	7,915	8.81	153,396	7,100	9.26
Total interest earning assets	240,848	10,018	8.32	212,474	9,114	8.58
Non-interest earning assets:						
Cash and due from banks	6,017			6,092		
Allowance for loan losses	(2,771)			(2,166)		
Other assets	15,191			14,828		
Total non-interest earning assets	18,437			18,754		
Total assets	\$ 259,285			\$ 231,228		
<b>Liabilities and Shareholders' Equity</b>						
Interest bearing liabilities:						
Interest bearing demand deposits	\$ 45,279	\$ 585	2.58%	\$ 43,056	\$ 610	2.83%
Savings deposits	44,362	601	2.71	42,069	593	2.82
Time deposits	108,381	2,885	5.32	90,829	2,480	5.46
Total interest bearing deposits	198,022	4,071	4.11	175,954	3,683	4.19
Short-term borrowings	7,822	190	4.86	5,927	152	5.13
Other borrowings	2,444	110	9.00	2,582	109	8.44
Total interest bearing liabilities	208,288	4,371	4.20	184,463	3,944	4.28
Non-interest bearing liabilities:						
Demand deposits	24,733			20,631		
Other liabilities	4,402			3,368		
Total non-interest bearing liabilities	29,135			23,999		
Shareholders' equity	21,862			22,766		
Total Liabilities and Shareholders' Equity	\$ 259,285			\$ 231,228		
Net interest income (tax equivalent basis)		5,647	4.12%		5,170	4.30%
Tax-equivalent basis adjustment		(197)			(224)	
Net interest income		\$ 5,450			\$ 4,946	
Net interest margin (tax equivalent basis)			4.69%			4.87%

[FN]

(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.

	Increase/(Decrease)		
	Six months ended June 30, 1997 Compared to Six months ended June 30, 1996		
	Variance due to		
	Volume	Rate	Net
	(dollars in thousands)		
<b>Assets</b>			
<b>Interest Earning Assets:</b>			
Federal funds sold	\$ (48)	\$ 17	\$ (31)
Interest bearing deposits with banks	12	1	13
Investment securities	(164)	61	(103)
Investment securities available for sale:			
Taxable investments	167	18	185
Tax-exempt securities	38	(13)	25
<b>Total investment securities</b>	<b>206</b>	<b>4</b>	<b>210</b>
Loans	1,712	(897)	815
<b>Total interest earning assets</b>	<b>1,718</b>	<b>(814)</b>	<b>904</b>
<b>Interest bearing liabilities:</b>			
Interest bearing demand deposits	70	(95)	(25)
Savings deposits	59	(51)	8
Time deposits	579	(174)	405
<b>Total interest bearing deposits</b>	<b>707</b>	<b>(319)</b>	<b>388</b>
Long-term borrowings	(12)	13	1
Other borrowings	60	(22)	38
<b>Total interest bearing liabilities</b>	<b>629</b>	<b>(202)</b>	<b>427</b>
Net interest income (tax-equivalent basis)	\$ 1,089	\$ (612)	\$ 477
	=====	=====	=====

[FN]

(1) 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.

Part II. Other Information

Item 1. Legal Proceedings

Not applicable

Item 2. Changes in Securities

Not applicable

Item 3. Defaults Upon Senior Securities

Not applicable

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

The Annual Meeting of shareholders of the Company was held on April 22, 1997.

Proposal 1 - Election of Directors

The following incumbent Class I Directors were nominated for and duly elected to the Board of Directors for a three year term expiring in 2000: Charles E. Case, William W. Davis, Jr. and John E. Marshall.

The results of the voting were as follows:

	Shares	
	For	Withheld
Charles E. Case	711,799	5,403
William W. Davis, Jr.	715,652	1,550
John E. Marshall	711,699	5,503

Item 5.

None.

Item 6.

None

Signatures

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Pursuant to the requirements of the Securities and 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.

Date: August 5, 1997

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

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

Date: August 5, 1997

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By: \s\ Lewis J. Critelli

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Lewis J. Critelli  
Senior Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

6-MOS  
DEC-31-1996  
JUN-30-1997  
8,996  
1,103  
2,500  
0  
43,849  
8,807  
9,130  
185,591  
2,940  
262,198  
220,454  
12,026  
4,596  
2,451  
0  
0  
90  
22,581  
262,198  
7,911  
1,829  
81  
9,821  
4,071  
4,371  
5,450  
550  
62  
3,953  
1,598  
1,598  
0  
0  
1,201  
1.45  
.42  
4.69  
2,885  
42  
0  
0  
2,616  
299  
73  
2,940  
2,940  
0  
0