

PEOPLES FINANCIAL SERVICES CORP/
Form 10-Q
August 11, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2008 or

Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the transition period from

No. 0-23863
(Commission File Number)

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

Pennsylvania
(State of Incorporation)

23-2391852
(IRS Employer ID Number)

50 Main Street
Hallstead, PA
(Address of Principal Executive Offices)

18822
(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months or for such shorter period that the registrant was required to file such reports, and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if smaller reporting company)

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

Number of shares outstanding as of July 31, 2008

COMMON STOCK (\$2 Par Value)
(Title of Class)

3,131,181
(Outstanding Shares)

PEOPLES FINANCIAL SERVICES CORP.
FORM 10-Q

For the Quarter Ended June 30, 2008

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

June 30, 2008 and December 31, 2007

(In thousands, except share and per share data)

	June 2008	Dec 2007
ASSETS:		
Cash and due from banks	\$ 9,464	\$ 8,051
Interest bearing deposits in other banks	811	555
Cash and cash equivalents	10,275	8,606
Securities available for sale	111,148	112,746
Loans	297,985	291,052
Allowance for loan losses	(2,602)	(2,451)
Loans, net	295,383	288,601
Bank premises and equipment, net	6,359	5,872
Accrued interest receivable	2,756	2,237
Intangible assets	947	1,076
Other real estate owned	5,171	5,237
Bank owned life insurance	7,769	7,614
Other assets	3,843	2,445
Total assets	\$ 443,651	\$ 434,434
LIABILITIES:		
Deposits:		
Non-interest bearing	\$ 57,866	\$ 53,731
Interest bearing	281,010	273,699
Total deposits	338,876	327,430
Accrued interest payable	1,201	925
Short-term borrowings	17,624	22,848
Long-term borrowings	42,816	38,534
Other liabilities	1,378	1,892
Total liabilities	401,895	391,629
STOCKHOLDERS' EQUITY:		
Common Stock, par value \$2 per share; authorized 12,500,000 shares; issued 3,341,251 shares; outstanding 3,128,181 shares and 3,138,493 shares June 30, 2008 and December 31, 2007, respectively	6,683	6,683
Surplus	3,093	3,083
Retained earnings	40,646	38,824
Accumulated other comprehensive loss	(3,932)	(1,390)
Treasury stock at cost 213,070 and 202,758 shares at June 30, 2008 and December 31, 2007, respectively	(4,734)	(4,395)
Total stockholders' equity	41,756	42,805
Total liabilities and stockholders' equity	\$ 443,651	\$ 434,434

See Notes to Consolidated Financial Statements

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

(In thousands, except per share data)

	Six Months Ended		Three Months Ended	
	June 30 2008	June 30 2007	June 30 2008	June 30 2007
INTEREST INCOME:				
Loans receivable, including fees	\$ 9,949	\$ 9,482	\$ 4,927	\$ 4,805
Securities:				
Taxable	1,940	1,712	974	757
Tax exempt	818	789	401	454
Other	12	59	6	20
Total interest income	12,719	12,042	6,308	6,036
INTEREST EXPENSE:				
Deposits	3,491	4,689	1,631	2,337
Short-term borrowings	201	304	69	129
Long-term borrowings	890	671	448	341
Total interest expense	4,582	5,664	2,148	2,807
Net interest income	8,137	6,378	4,160	3,229
PROVISION FOR LOAN LOSSES	255	240	135	120
Net interest income after provision for loan losses	7,882	6,138	4,025	3,109
OTHER INCOME:				
Customer service fees	978	953	509	505
Investment division commission income	160	185	76	106
Earnings on investment in life insurance	155	151	76	76
Other income	263	276	141	106
Realized gain on sale of interest in insurance agency	0	220	0	220
Net realized gains (losses) on sales of securities available for sale	16	(136)	(10)	(165)
Other than temporary security impairment	(265)	0	(83)	0
Total other income	1,307	1,649	709	848
OTHER EXPENSES:				
Salaries and employee benefits	2,340	2,358	1,130	1,177
Occupancy	372	377	174	179
Equipment	239	263	114	134
FDIC insurance and assessments	75	75	38	38
Professional fees and outside services	285	179	115	83
Computer services and supplies	461	381	230	177
Taxes, other than payroll and income	177	185	87	92
Amortization expense-deposit acquisition premiums	129	126	64	65
Stationary and printing supplies	170	162	92	78
Other	927	805	470	448
Total other expenses	5,175	4,911	2,514	2,471
Income before income taxes	4,014	2,876	2,220	1,486

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INCOME TAXES		895		464		516		197
Net income	\$	3,119	\$	2,412	\$	1,704	\$	1,289
Net income per share, basic	\$	1.00	\$	0.77	\$	0.54	\$	0.41
Net income per share, diluted	\$	1.00	\$	0.77	\$	0.54	\$	0.41

See Notes to Consolidated Financial Statements

PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2008 AND 2007
(UNAUDITED)

(In thousands except share data)	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, December 31, 2007	\$ 6,683	\$ 3,083	\$ 38,824	\$ (1,390)	\$ (4,395)	\$ 42,805
Cumulative effect of adoption of new accounting principle on January 1, 2008 (Note 6)	0	0	(71)	0	0	(71)
Comprehensive income						
Net income	0	0	3,119	0	0	3,119
Net change in unrealized losses on securities available for sale, net of reclassification adjustment and taxes	0	0	0	(2,542)	0	(2,542)
Total comprehensive income						577
Stock option expense	0	1	0	0	0	1
Cash dividends, (\$0.38 per share)	0	0	(1,226)	0	0	(1,226)
Treasury stock purchase (20,000 shares)	0	0	0	0	(506)	(506)
Treasury stock issued for stock option plan (9,688 shares)	0	9	0	0	167	176
Balance, June 30, 2008	\$ 6,683	\$ 3,093	\$ 40,646	\$ (3,932)	\$ (4,734)	\$ 41,756
Balance, December 31, 2006	\$ 6,683	\$ 3,046	\$ 36,336	\$ (395)	\$ (4,430)	\$ 41,240
Comprehensive income						
Net income	0	0	2,412	0	0	2,412
Net change in unrealized losses on securities available for sale, net of reclassification adjustment and taxes	0	0	0	(1,573)	0	(1,573)
Total comprehensive income						839
Stock option expense	0	1	0	0	0	1
Cash dividends, (\$0.38 per share)	0	0	(1,191)	0	0	(1,191)
Treasury stock purchase (3,500 shares)	0	0	0	0	(94)	(94)
Treasury stock issued for stock option plan (6,138 shares)	0	31	0	0	94	125
Balance, June 30, 2007	\$ 6,683	\$ 3,078	\$ 37,557	\$ (1,968)	\$ (4,430)	\$ 40,920

See Notes to Consolidated Financial Statements

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

(In thousands)	Six Months Ended	
	June 30, 2008	June 30, 2007
Cash Flows from Operating Activities		
Net income	\$ 3,119	\$ 2,412
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	430	444
Provision for loan losses	255	240
(Gain) loss on sale of other real estate owned	(15)	4
Amortization of securities' premiums and accretion of discounts, net	82	162
Amortization of deferred loan costs	176	152
Gain on sale of interest in insurance agency	0	(220)
(Gains) losses on sales of securities available for sale, net	(16)	136
Other than temporary security impairment	265	0
Stock option expense	1	1
Proceeds from the sale of loans originated for sale	3,420	3,226
Net (gain) loss on sale of loans originated for sale	(35)	6
Loans originated for sale	(3,258)	(3,514)
Net earnings on investment in life insurance	(155)	(151)
Increase in accrued interest receivable	(519)	(107)
(Increase) decrease in other assets	(89)	90
Increase (decrease) in accrued interest payable	276	(38)
Decrease in other liabilities	(585)	(91)
Net cash provided by operating activities	3,352	2,752
Cash Flows from Investing Activities		
Proceeds from sale of interest in insurance agency	0	551
Proceeds from sale of available for sale securities	46,018	35,791
Proceeds from maturities of and principal payments received on available for sale securities	4,273	10,239
Purchase of available for sale securities	(52,875)	(47,480)
Net increase in loans	(7,439)	(5,130)
Purchase of premises and equipment	(788)	(233)
Proceeds from sale of other real estate owned	180	15
Net cash used in investing activities	(10,631)	(6,247)
Cash Flows from Financing Activities		
Cash dividends paid	(1,226)	(1,191)
Increase in deposits	11,446	1,949
Proceeds from long-term borrowings	5,000	3,275
Repayment of long-term borrowings	(718)	(8,353)
Increase (decrease) in short-term borrowings	(5,224)	2,091
Purchase of treasury stock	(506)	(94)
Proceeds from sale of treasury stock	176	125
Net cash provided by (used in) financing activities	8,948	(2,198)
Net increase (decrease) in cash and cash equivalents	1,669	(5,693)

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Cash and cash equivalents, beginning of year		8,606		12,380
Cash and cash equivalents, end of period	\$	10,275	\$	6,687
Supplemental disclosures of cash paid				
Interest paid	\$	4,306	\$	5,702
Income taxes paid	\$	1,030	\$	320
Non-cash investing and financing activities				
Transfers from loans to other real estate owned through foreclosure	\$	99	\$	94

See Notes to Consolidated Financial Statements

NOTE 1. BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Peoples Financial Services Corp. (the “Corporation” or the “Company”) and its wholly owned subsidiaries, Peoples National Bank (the “Bank”), Peoples Advisors, LLC (“Advisors”), and Peoples Financial Capital Corporation. The Bank has two wholly owned subsidiaries, Peoples Financial Leasing, LLC and Peoples Investment Holdings, LLC. All material inter-company accounts and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information as well as with instructions for Form 10Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the six month period ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ended December 31, 2008. For further information, refer to the consolidated financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2007.

NOTE 2. EARNINGS PER SHARE

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

	Six Months Ended		Three Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Net income applicable to common stock	\$ 3,119,000	\$ 2,412,000	\$ 1,704,000	\$ 1,289,000
Weighted average common shares outstanding	3,125,284	3,134,389	3,126,855	3,135,462
Effect of dilutive securities, stock options	6,058	10,408	5,139	10,252
Weighted average common shares outstanding used to calculate diluted earnings per share	3,131,342	3,144,797	3,131,994	3,145,714
Basic earnings per share	\$ 1.00	\$ 0.77	\$ 0.54	\$ 0.41
Diluted earnings per share	\$ 1.00	\$ 0.77	\$ 0.54	\$ 0.41

Stock options for 11,959 and 12,496 shares of common stock were not considered in computing diluted earnings per share for the three and six months ended June 30, 2008 and for the three and six months ended June 30, 2007, respectively because they are antidilutive.

NOTE 3. OTHER COMPREHENSIVE INCOME

The components of other comprehensive income (loss) and related tax effects for the six months and three months ended June 30, 2008 and 2007 are as follows:

(In thousands)	Six Months Ended		Three Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Unrealized holding losses on available for sale securities	\$ (3,835)	\$ (2,519)	\$ (2,176)	\$ (2,295)
Less: Reclassification adjustment for gains (losses) realized in net income	16	(136)	(10)	(165)
Net unrealized losses	(3,851)	(2,383)	(2,166)	(2,130)
Tax effect	1,309	810	736	724
Other comprehensive loss	\$ (2,542)	\$ (1,573)	\$ (1,430)	\$ (1,406)

NOTE 4. STOCK-BASED COMPENSATION

As of June 30, 2008, all stock options were fully vested and there are no unrecognized compensation costs related to stock options. For the six month periods ending June 30, 2008 and 2007, respectively, there were no stock options granted.

NOTE 5. GUARANTEES

The Company does not issue any guarantees that would require liability recognition or disclosure, other than standby letters of credit. Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Company had \$4,744,000 of standby letters of credit as of June 30, 2008. The Bank uses the same credit policies in making conditional obligations as it does for on-balance sheet instruments.

The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at June 30, 2008 was \$4,744,000, and the approximate value of underlying collateral upon liquidation, that would be expected to cover this maximum potential exposure, was \$3,434,000.

NOTE 6. NEW ACCOUNTING STANDARDS

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133" (Statement 161). Statement 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. Statement 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 has been applied, and the impact that hedges have on an entity's financial position, financial performance, and cash flows. Statement 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions." This FSP addresses the issue of whether or not these transactions should be viewed as two separate transactions or as one "linked" transaction. The FSP includes a "rebuttable presumption" that presumes linkage of the two transactions unless the presumption can be overcome by meeting certain criteria. The FSP will be effective for fiscal years beginning after November 15, 2008 and will apply only to original transfers made after that date; early adoption will not be allowed. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In September 2006, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 06-4 (EITF 06-4) "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements." The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policies that are associated with a postretirement benefit. EITF 06-4 requires that for a split-dollar life insurance arrangement within the scope of the Issue, an employer should recognize a liability for future benefits in accordance with FASB No. 106 (if, in substance, a postretirement benefit plan exists) or, Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The Company adopted this standard on January 1, 2008 as a change in accounting principle through a cumulative-effect adjustment to retained earnings totaling \$71,000.

FASB Statement No. 157 "Fair Value Measurements" defines fair value, establishes a framework for measuring the fair value in generally accepted accounting principles, and expands disclosures about fair value measurements (see Note 7 – Fair Value Measurements).

FASB Statement No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115" permits entities to choose to measure eligible items at fair value at specified election dates (see Note 7 – Fair Value Measurements).

FASB Statement No. 141 (R) "Business Combinations" was issued in December of 2007. This Statement establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The Statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance will become effective as of the beginning of a company's fiscal year beginning after December 15, 2008. This new pronouncement will impact the Company's accounting for business combinations completed beginning January 1, 2009.

FASB Statement No. 160 "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51" was issued in December of 2007. This Statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The guidance will become effective as of the beginning of a company's fiscal year beginning after December 15, 2008. The Company believes that this new pronouncement will have an immaterial impact on the Company's consolidated financial statements in future periods.

Staff Accounting Bulletin No. 110 (SAB 110) amends and replaces Question 6 of Section D.2 of Topic 14, "Share-Based Payment," of the Staff Accounting Bulletin series. Question 6 of Section D.2 of Topic 14 expresses the views of the staff regarding the use of the "simplified" method in developing an estimate of expected term of "plain vanilla" share options and allows usage of the "simplified" method for share option grants prior to December 31, 2007. SAB 110 allows public companies which do not have historically sufficient experience to provide a reasonable estimate to continue use of the "simplified" method for estimating the expected term of "plain vanilla" share option grants after December 31, 2007. The Company adopted SAB 110 on January 1, 2008 and it did not have an effect on the consolidated financial statements.

Staff Accounting Bulletin No. 109 (SAB 109), "Written Loan Commitments Recorded at Fair Value Through Earnings" expresses the views of the staff regarding written loan commitments that are accounted for at fair value through earnings under generally accepted accounting principles. To make the staff's views consistent with current authoritative accounting guidance, the SAB revises and rescinds portions of SAB No. 105, "Application of Accounting Principles to Loan Commitments." Specifically, the SAB revises the SEC staff's views on incorporating expected net future cash flows related to loan servicing activities in the fair value measurement of a written loan commitment. The SAB retains the staff's views on incorporating expected net future cash flows related to internally-developed intangible assets in the fair value measurement of a written loan commitment. The staff expects registrants to apply the views in Question 1 of SAB 109 on a prospective basis to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The Company adopted SAB 109 on January 1, 2008 and it did not have an effect on the consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position (“FSP”) FAS 142-3, “Determination of the Useful Life of Intangible Assets.” This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”). The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, and other GAAP. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position (FSP) EITF 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.” This FSP clarifies that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied. This FSP is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In June 2008, the FASB ratified EITF Issue No. 07-5, “Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity’s Own Stock” (EITF 07-5). EITF 07-5 provides that an entity should use a two step approach to evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock, including evaluating the instrument’s contingent exercise and settlement provisions. It also clarifies the impact of foreign currency denominated strike prices and market-based employee stock option valuation instruments on the evaluation. EITF 07-5 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

NOTE 7. FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, "Fair Value Measurements," for financial assets and financial liabilities. In accordance with Financial Accounting Standards Board Staff Position (FSP) No. 157-2, "Effective Date of FASB Statement No. 157," the Company will delay application of SFAS 157 for non-financial assets and non-financial liabilities, until January 1, 2009. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability.

The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value effective January 1, 2008. In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counter party credit quality, the Company's credit worthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities Available for Sale. Securities classified as available for sale are reported at fair value utilizing Level 1, 2, and 3 inputs. For Level 1 securities, the Company obtains unadjusted quoted prices in active markets for identical securities as of the measurement date. For the Level 2 securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. For the Level 3 securities, the Company obtains fair value based on its own assumptions, including primarily the price the Company paid for the securities.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Securities available for sale	\$ 885	\$ 109,198	\$ 1,065	\$ 111,148

Level 3 Input Securities available for sale were valued at \$1,065,000 at both December 31, 2007 and June 30, 2008.

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of an intangible impairment test. Certain non-financial assets measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of an intangible impairment test, as well as intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment including other real estate owned. As stated above, SFAS 157 will be applicable to these fair value measurements beginning January 1, 2009.

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115." SFAS 159 permits the Company to choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, thus the Company may record identical financial assets and liabilities at fair value or by another measurement basis permitted under generally accepted accounting principles, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments. Adoption of SFAS 159 on January 1, 2008 did not have a significant impact on the Company's consolidated financial statements.

NOTE 8 – RECLASSIFICATIONS

Certain amounts in the 2007 financial statements have been reclassified to conform with 2008's presentation. These reclassifications had no effect on 2007 net income.

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

The following discussion and analysis of the consolidated financial statements of the Corporation is presented to provide insight into management's assessment of financial results. The Corporation's subsidiaries, Peoples National Bank and Peoples Advisors, LLC, provide financial services to individuals and businesses within the Bank's primary market area made up of Susquehanna, Wyoming and Northern Lackawanna Counties in Pennsylvania, and Broome County in New York. The Bank is a member of the Federal Reserve System and subject to regulation, supervision, and examination by the Office of the Comptroller of the Currency. Advisors is a member of the National Association of Securities Dealers (NASD), which also acts as the primary regulator for Advisors. Peoples Financial Leasing, LLC is a subsidiary of the Bank and provides employee leasing services to the Bank. Peoples Investment Holdings, LLC is also a subsidiary of the Bank and its main activities are the maintenance and management of its intangible investments and the collection and distribution of the income from such investments or from tangible investments located outside of Delaware. Likewise, Peoples Financial Capital Corporation is a subsidiary of the Company and its main activities are the maintenance and management of its intangible investments and the collection and distribution of the income from such investments or from tangible investments located outside of Delaware.

On June 24, 2008, Peoples National Bank entered into a \$678,500 contract for the construction of its first physical location in Lackawanna County, Pennsylvania.

CAUTIONARY STATEMENT CONCERNING FORWARD LOOKING INFORMATION

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

CRITICAL ACCOUNTING POLICIES

Disclosure of the Company's significant accounting policies is included in Note 1 to the consolidated financial statements of the Company's Annual Report on Form 10-K for the year ended December 31, 2007. Some of these policies are particularly sensitive requiring significant judgments, estimates and assumptions to be made by Management. Additional information is contained on page 24 of this report for the provision and allowance for loan losses.

OVERVIEW

Net income for the six months ended June 30, 2008 increased 29.31% to \$3.119 million as compared to \$2.412 million for the same period in 2007. Diluted earnings per share increased 29.87% to \$1.00 per share for the first half of 2008 from \$.77 per share in the same six month period in 2007. At June 30, 2008, the Company had total assets of \$443.651 million, net loans of \$295.383 million, and total deposits of \$338.876 million.

FINANCIAL CONDITION

Cash and Cash Equivalents:

At June 30, 2008, cash, federal funds sold, and deposits with other banks totaled \$10.275 million as compared to \$8.606 million on December 31, 2007. The increase in cash and cash equivalents from December 31, 2007 has been due to normal operational circumstances.

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

Securities:

Securities totaled \$111.148 million on June 30, 2008, decreasing by \$1.598 million, or 1.42% from the December 31, 2007 total of \$112.746 million.

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

Securities available for sale are accounted for at fair value, with unrealized gains or losses net of deferred income taxes reported in the accumulated other comprehensive income component of stockholders' equity. The carrying value of securities, as of June 30, 2008, included an unrealized loss of \$5.957 million reflected as accumulated other comprehensive loss of \$3.932 million in stockholders' equity, net of deferred income taxes of \$2.025 million. This compares to an unrealized loss of \$2.106 million at December 31, 2007 reflected as accumulated other comprehensive loss of \$1.390 million, net of deferred income taxes of \$716 thousand. The majority of the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities and management believes that these unrealized losses represent a temporary impairment of those securities. As long term rates increase, the underlying value of securities owned by the Company decrease, creating an unrealized loss. The Company has the intent and ability to hold such securities until maturity or market price recovery. Management believes that the unrealized losses represent temporary impairment of the securities.

Management evaluates securities for other than temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (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. See further discussion of this issue as it relates to the second quarter results of operations in the "Other Income" section.

At June 30, 2008, the Company had 5 Government Agency obligations, 70 obligations of state and political subdivisions, 19 mortgage-backed securities, 14 corporate debt securities, 2 preferred equity securities, and 16 common equity securities in an unrealized loss position. Comparably, at December 31, 2007, the Company had 68 obligations of state and political subdivisions, 36 mortgage-backed securities, 5 corporate debt securities, 2 preferred equity securities, and 16 common equity securities in an unrealized loss position. Management has continuously monitored the unrealized loss position of the preferred equity securities. A decision will be made in the third quarter of 2008 based on actions taken by those entities to strengthen their finances and the resulting values in those securities to decide whether an other than temporary impairment needs to be recorded. As of June 30, 2008, the current value of the 2 preferred equity securities is \$1,595,000 which represents an unrealized loss of \$772,000.

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

Loans:

Net loans increased \$6.782 million, or 2.35%, to \$295.383 million as of June 30, 2008 from \$288.601 million as of December 31, 2007. Of the loan growth experienced in the first six months of 2008, the only growth experienced was in commercial loans. Commercial loans, which include traditional commercial loans as well as commercial real estate mortgages, increased \$9.019 million, or 5.77%, to \$165.377 million as of June 30, 2008 compared to \$156.358 million at year end December 31, 2007. Residential real estate mortgages decreased \$1.323 million, or 1.13%, to \$115.599 million as of June 30, 2008 compared to \$116.922 million as of December 31, 2007. Consumer loans decreased \$771 thousand, or 4.45%, to \$ 16.556 million as of March 31, 2008 compared to \$17.327 million at year end December 31, 2007.

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

The collective increase in loans corresponds with the increase in deposits discussed further in the deposits section of this document.

Other Assets:

Other assets increased \$1.398 million, or 57.18%, to \$3.843 million as of June 30, 2008 from \$2.445 million as of December 31, 2007. The most significant increase in other assets was the \$1.309 million increase in deferred taxes on unrealized losses on securities available for sale from December 31, 2007 to June 30, 2008. Other increases and decreases in other assets were due, in part, to the pre-payment of Pennsylvania shares tax for 2008 and prepaid expenses. Those variances offset one another.

Deposits:

Deposits are attracted from within the Bank's primary market area through the offering of various deposit instruments including NOW accounts, money market accounts, savings accounts, certificates of deposit, and IRA's. During the six month period ended June 30, 2008, total deposits increased by \$11.446 million, or 3.50%, to \$338.876 million compared to \$327.430 million as of December 31, 2007. Time deposits increased by \$9.234 million, or 8.41%, to \$119.078 million when compared to year end December 31, 2007 at \$109.844 million. Other core deposit relationships increased or decreased as follows; demand deposits were up \$4.135 million, or 7.70%, to \$57.866 million when compared to \$53.731 million at December 31, 2007. Interest-bearing checking deposits were down \$39 thousand, or 0.06%, to \$64.111 million compared to \$64.150 million as of December 31, 2007. And finally, savings deposits were down \$1.550 million, or 1.56%, to \$97.821 million when compared to \$99.371 million at December 31, 2007.

The trend in the second quarter of 2008 was expected due to the nature of those deposits affected. The current economic climate has induced consumers to seek higher interest rates offered by time deposits. Short term and core deposit rates have decreased significantly since mid-year 2007. As such, time deposits offer consumers higher interest rates while at the same time offering the relative safety offered by a commercial bank and FDIC insurance. Increases to non-interest bearing deposits have also increased in the second quarter of 2008. The Bank has experienced a significant inflow of funds from natural gas lease contracts entered into by Bank customers.

Borrowings:

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

Total short-term borrowings at June 30, 2008 were \$ 17.624 million as compared to \$22.848 million as of December 31, 2007, a decrease of \$5.224 million, or 22.86%. Long-term borrowings were \$42.816 million as of June 30, 2008 compared to \$38.534 million as of December 31, 2007, an increase of \$4.282 million, or 11.11%. The increase in long-term borrowings included a \$5 million term borrowing which was entered into with the FHLB in January of 2008.

Capital:

The adequacy of the Company's capital is reviewed on an ongoing basis with reference to the size, composition and quality of the Company's resources and regulatory guidelines. Management seeks to maintain a level of capital sufficient to support existing assets and anticipated asset growth, maintain favorable access to capital markets, and preserve high quality credit ratings. As of June 30, 2008, regulatory capital to total average assets was 9.18% as compared to 9.09% on December 31, 2007. The Company repurchases its stock in the open market, or from individuals as warranted, to leverage the capital account and to provide stock for its stock option plan and dividend reinvestment plan. In the six months ended June 30, 2008, the Company purchased 20,000 shares for the treasury at a total cost of \$505,500.

The Company has complied with the standards of capital adequacy mandated by the banking regulators. The bank regulators have established "risk-based" capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of various assets the banks hold in their portfolios. A weight category of either 0% (lowest risk asset), 20%, 50%, or 100% (highest risk assets) is assigned to each asset on the balance sheet. Capital is being maintained in compliance with risk-based capital guidelines. The Company's Tier 1 capital to risk weighted asset ratio was 11.94% and the total capital ratio to risk weighted asset ratio was 12.72% at June 30, 2008. The Company is deemed to be well-capitalized under regulatory standards.

Liquidity:

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

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

Off-Balance Sheet Arrangements:

The Company's consolidated financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist primarily of commitments to grant new loans, unfunded commitments of existing loans and letters of credit made under the same standards as on-balance sheet instruments. Unused commitments on June 30, 2008 totaled \$48.179 million, which consisted of \$31.647 million in unfunded commitments of existing loans, \$11.788 million to grant new loans and \$4.744 million in letters of credit. Due to fixed maturity dates and specified conditions within these instruments, many will expire without being drawn upon. Management believes that amounts actually drawn upon can be funded in the normal course of operations and therefore, do not represent a significant liquidity risk to the Company.

Interest Rate Sensitivity:

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

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

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

The following table sets forth the Company’s interest sensitivity analysis as of June 30, 2008:

INTEREST RATE SENSITIVITY ANALYSIS

(Dollars in thousands)	Maturity or Re-pricing In:				
	3 Months	3-6 Months	6-12 Months	1-5 Years	Over 5 Years
RATE SENSITIVE ASSETS					
Loans	\$ 130,002	\$ 15,093	\$ 13,183	\$ 71,079	\$ 68,628
Securities	8,340	1,700	5,268	34,396	61,444
Interest bearing deposits in other banks	811	0	0	0	0
Total rate sensitive assets	139,153	16,793	18,451	105,475	130,072
Cumulative rate sensitive assets	\$ 139,153	\$ 155,946	\$ 174,397	\$ 279,872	\$ 409,944
RATE SENSITIVE LIABILITIES					
Interest bearing checking	\$ 28,880	\$ 0	\$ 0	\$ 0	\$ 0
Money market deposits	35,231	0	0	0	0
Regular savings	97,821	0	0	0	0
CDs and IRAs	45,476	31,422	8,117	30,951	3,112
Short-term borrowings	17,624	0	0	0	0
Long-term borrowings	2,811	314	500	21,334	17,857
Total rate sensitive liabilities	227,843	31,736	8,617	52,285	20,969
Cumulative rate sensitive liabilities	\$ 227,843	\$ 259,579	\$ 268,196	\$ 320,481	\$ 341,450
Period gap	\$ (88,690)	\$ (14,943)	\$ 9,834	\$ 53,190	\$ 109,103
Cumulative gap	\$ (88,690)	\$ (103,633)	\$ (93,799)	\$ (40,609)	\$ 68,494
Cumulative RSA to RSL	61.07 %	60.08 %	65.03 %	87.33 %	120.06%
Cumulative gap to total assets	(19.99)%	(23.36)%	(21.14)%	(9.15)%	15.44%

RESULTS OF OPERATIONS

Net Interest Income:

For the three months ended June 30, 2008, total interest income increased by \$272 thousand, or 4.51%, to \$6.308 million as compared to \$6.036 million for the three months ended June 30, 2007. This increase was primarily due to the increase in average loans which increased \$23.417 million, or 8.52%, to \$298.412 million for the quarter ended June 30, 2008 as compared to \$274.995 million for the same three month period in 2007. Overall average earning assets increased to \$408.926 million for the three months ended June 30, 2008 as compared to \$384.360 million for the three months ended June 30, 2007. The resulting interest earned on loans was \$4.927 million for the three month period ended June 30, 2008 compared to \$4.805 million for the same period in 2007, an increase of \$122 thousand, or 2.54%. The overall yield on earning assets, on a fully tax equivalent basis, decreased for the three months ended June 30, 2008 to 6.53% as compared to 6.66% for the three months ended June 30, 2007. This has been due to lower market yields available for investment.

For the six months ended June 30, 2008, total interest income increased by \$677 thousand, or 5.62%, to \$12.719 million as compared to \$12.042 million for the six months ended June 30, 2007. This increase was also primarily due to the increase in average total loans. Average total loans increased to \$295.169 million for the six months ended June 30, 2008 as compared to \$272.910 million for the six months ended June 30, 2007. The resulting interest earned on loans was \$9.949 million for the six-month period ended June 30, 2008 compared to \$9.482 million for the same period in 2007, an increase of \$467 thousand, or 4.93%. The overall yield on earning assets, on a tax equivalent basis, decreased for the six months ended June 30, 2008 to 6.61% as compared to 6.66% for the six months ended June 30, 2007 as average earning assets increased to \$407.354 million for the period ended June 30, 2008 as compared to \$383.185 million for the same period in 2007.

Total interest expense decreased by \$659 thousand, or 23.48%, to \$2.148 million for the three months ended June 30, 2008 from \$2.807 million for the three months ended June 30, 2007. This decrease was attributable to the decrease in the cost of funds. The cost of funds decreased to 2.56% for the three months ended June 30, 2008 as compared to 3.55% for the second quarter of 2007. Average interest bearing liabilities on the other hand increased to \$337.383 million for the three months ended June 30, 2008 as compared to \$316.848 million for the three months ended June 30, 2007. This increase was due to the increase in average time deposits. Average time deposits increased to \$119.247 million for the three month period ended June 30, 2008 as compared to \$101.659 million for the same period in 2007.

Total interest expense decreased by \$1.082 million, or 19.10%, to \$4.582 million for the six months ended June 30, 2008 from \$5.664 million for the six months ended June 30, 2007. As with the quarterly interest expense, this decrease was primarily attributable to the decrease in the cost of funds, which decreased to 2.74% for the six month period ended June 30, 2008 as compared to 3.60% for the same period in 2007. Offsetting the decrease in the cost of funds was the increase to average interest bearing liabilities to \$335.757 million for the six months ended June 30, 2008 as compared to \$316.865 million for the six months ended June 30, 2007. The year-to-date increase in average interest bearing liabilities was also due to the increase in average time deposits. Average time deposits increased to \$116.998 million for the six month period ended June 30, 2008 when compared to \$100.739 million for the six month period ended June 30, 2007.

Net interest income increased by \$931 thousand, or 28.83%, to \$4.160 million for the three months ended June 30, 2008 from \$3.229 million for the three months ended June 30, 2007. The Bank's net interest spread increased to 3.97% for the three months ended June 30, 2008 from 3.11% for the three months ended June 30, 2007 on a fully tax equivalent basis. The net interest margin increased to 4.42% for the three month period ended June 30, 2008 from 3.73% for the three month period ended June 30, 2007 on a fully tax equivalent basis. The yield curve has become relatively steep since the middle of 2007 when the Federal Reserve began their process of injecting liquidity into the financial markets through the implementation of lower overnight and discount rates. The preceding discussion is an indication of the results of how lower funding costs have affected the company. As deposit liability rates are affected by the short end of the yield curve and loan and securities rates tend to follow the long end of the yield curve, the result has been an increase in net interest margin between the two periods compared.

Net interest income increased by \$1.759 million, or 27.58%, to \$8.137 million for the six months ended June 30, 2008 from \$6.378 million for the six months ended June 30, 2007. The Bank's net interest spread increased to 3.87% for the six months ended June 30, 2008 from 3.06% for the six months ended June 30, 2007 on a fully tax equivalent basis. The net interest margin increased to 4.35% for the six month period ended June 30, 2008 from 3.68% for the six month period ended June 30, 2007 on a fully tax equivalent basis. The increase in net interest spread and net interest income for the six months ended June 30, 2008 when compared to the six months ended June 30, 2007 is also due to the repositioning of the yield curve which was discussed with the quarterly results.

Below are the tables which set forth average balances and corresponding yields for the six-month and three-month periods ended June 30, 2008, and June 30, 2007:

Distribution of Assets, Liabilities and Stockholders' Equity;
Interest Rates and Interest Differential (year to date)

(Dollars in thousands)	June 2008		Six months ended		June 2007	
	Average Balance	Interest	(2) Yield/ Rate	Average Balance	Interest	(2) Yield/ Rate
ASSETS						
Loans						
Real estate	\$ 116,685	\$ 3,763	6.49%	\$ 114,298	\$ 3,746	6.61%
Installment	17,159	682	7.99%	16,896	702	8.38%
Commercial	137,134	4,960	7.27%	121,137	4,566	7.60%
Tax exempt (1)	23,725	521	6.69%	20,128	440	6.68%
Other loans	466	23	9.93%	451	28	12.52%
Total loans	295,169	9,949	6.96%	272,910	9,482	7.17%
Investment securities (AFS)						
Taxable	70,514	1,940	5.53%	67,322	1,712	5.13%
Non-taxable (1)	40,680	818	6.12%	40,883	789	5.90%
Total securities	111,194	2,758	5.75%	108,205	2,501	5.42%
Time deposits with other banks	809	10	2.49%	635	18	5.72%
Fed funds sold	182	2	2.21%	1,435	41	5.76%
Total earning assets	407,354	12,719	6.61%	383,185	12,042	6.66%
Less: allowance for loan losses	(2,481)			(1,887)		
Cash and due from banks	6,477			6,502		
Premises and equipment, net	5,855			5,786		
Other assets	18,335			17,530		
Total assets	\$ 435,540			\$ 411,116		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Deposits						
Interest bearing demand	\$ 27,483	137	1.00%	\$ 25,091	142	1.14%
Regular savings	97,048	713	1.48%	109,235	1,873	3.46%
Money market savings	34,631	346	2.01%	35,051	565	3.25%
Time	116,998	2,295	3.94%	100,739	2,109	4.22%
Total interest bearing deposits	276,160	3,491				