

NORWOOD FINANCIAL CORP  
Form S-4  
February 11, 2011

As filed with the Securities and Exchange Commission on February 11, 2011

Registration No. 333 - \_\_\_\_\_

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form S-4  
REGISTRATION STATEMENT  
UNDER THE SECURITIES ACT OF 1933

NORWOOD FINANCIAL CORP.  
(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	6022 (Primary Standard Industrial Classification Code Number)	23-2828306 (I.R.S. Employer Identification Number)
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717 Main Street  
Honesdale, Pennsylvania 18431  
(570) 253-1455  
(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive  
Offices)

Lewis J. Critelli, President  
717 Main Street  
Honesdale, Pennsylvania 18431  
(570) 253-1455  
(Name, address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement and the conditions to the consummation of the merger described herein have been satisfied or waived.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

If applicable, place an X in the box to designate the appropriate rule provision relied upon in conducting this transaction:

Exchange Act Rule 13e-4(i) (Cross-Border Issuer Tender Offer)

Exchange Act Rule 14d-1(d) (Cross-Border Third-Party Tender Offer)

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered(1)	Proposed maximum offering price per unit(2)	Proposed maximum aggregate offering price(2)	Amount of registration fee(2)
Common Stock, \$.10 par value	532,402	Not Applicable	\$12,287,489	\$1,426.58

(1) Represents the estimated maximum number of shares of Norwood Financial Corp. common stock estimated to be issuable upon the consummation of the merger of North Penn Bancorp, Inc. with and into Norwood and is computed based upon the estimated number of shares of North Penn Bancorp, Inc. common stock outstanding or to be issued in connection with grants of restricted stock as of February 9, 2011 (1,336,130) of which 779,619 shares will be exchanged for shares of Norwood common stock and (y) the exchange ratio of 0.6829. Pursuant to Rule 416, this Registration Statement also covers an indeterminate number of shares of common stock as may become issuable as a result of stock splits, stock dividends or similar transactions.

(2) Pursuant to Rule 457(f) under the Securities Act of 1933, as amended, and solely for the purpose of calculating the registration fee, the proposed maximum aggregate offering price is based on the average of the high and low prices of North Penn Bancorp, Inc. common stock on February 8, 2011 (\$17.16) and the estimated maximum number of

shares of North Penn Bancorp, Inc. common stock to be received by Norwood Financial Corp. in the merger (1,336,130) less the cash to be paid in exchange for such shares of \$10,640,502.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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Information contained herein is subject to completion or amendment. A registration statement relating to the shares of Norwood Financial Corp. common stock to be issued in the merger has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This proxy statement/prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale is not permitted or would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.

PRELIMINARY PROXY STATEMENT/PROSPECTUS  
DATED FEBRUARY 11, 2011, SUBJECT TO COMPLETION

[NORTH PENN LOGO]

A Merger Proposal — Your Vote Is Very Important

To the Shareholders of North Penn Bancorp, Inc.:

You are cordially invited to attend a special meeting of the shareholders of North Penn Bancorp, Inc. (North Penn) to be held on [ ] at [ ], local time, at [ ].

At the special meeting, you will be asked to consider the merger of North Penn and Norwood Financial Corp. (Norwood) and adopt the Agreement and Plan of Merger (the merger agreement) dated December 14, 2010, that North Penn and North Penn Bank entered into with Norwood and Wayne Bank, a wholly owned subsidiary of Norwood. You will also be asked to approve the adjournment, postponement, or continuation of the special meeting, if necessary, to solicit additional proxies in favor of adoption of the merger agreement.

If the merger is completed, each outstanding share of North Penn common stock will be converted into the right to receive either: (1) \$19.12 in cash, without interest, or (2) 0.6829 of a share of Norwood common stock. You will be able to elect to receive cash for all of your shares of North Penn common stock, Norwood common stock for all of your shares of North Penn common stock or cash for some of your shares of North Penn common stock and Norwood common stock for the remainder. Regardless of your choice, however, elections will be limited by the requirement that the aggregate amount of cash to be paid by Norwood (which includes, for this purpose, cash paid in settlement of stock options, unallocated shares held by the North Penn employee stock ownership plan and any dissenting shares) must equal \$12,194,000. Therefore, all allocations of cash and Norwood common stock that you will receive will depend on the elections of other North Penn shareholders. The federal income tax consequences of the merger to you will depend on whether you receive cash, stock or a combination of cash and stock in exchange for your shares of North Penn common stock.

Under the terms of the merger agreement, the cash consideration and the exchange ratio will remain fixed, while the value of the stock consideration will fluctuate with the market price of Norwood common stock. Based on the closing price of Norwood common stock on the NASDAQ Global Market on December 14, 2010, the last trading day before public announcement of the merger agreement, the value of the stock consideration represented approximately \$19.62 in value for each share of North Penn common stock. You should obtain current stock price quotations for Norwood and North Penn common stock. Norwood common stock trades on the NASDAQ Global Market under the symbol “NWFL” and North Penn common stock trades on the OTC Bulletin Board under the symbol “NPBP.”

Your board of directors has unanimously determined that the merger and the merger agreement are fair and in the best interests of North Penn and its shareholders and unanimously recommends that you vote "FOR" approval of the merger agreement and the merger. The merger cannot be completed unless a majority of the votes cast at the special meeting at which a quorum is present vote to approve the merger agreement. Whether or not you plan to attend the special meeting of shareholders, please take the time to vote by completing the enclosed proxy card and mailing it in the enclosed envelope. If you sign, date and mail your proxy card without indicating how you want to vote, your proxy will be counted as a vote "FOR" adoption of the merger agreement and "FOR" the proposal to adjourn the special meeting, if necessary, to solicit additional votes in favor of adoption of the merger agreement.

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This proxy statement/prospectus provides you with detailed information about the proposed merger. It also contains information about Norwood and North Penn and related matters. You are encouraged to read this document carefully. In particular, you should read the "Risk Factors" section beginning on page 17 for a discussion of the risks you should consider in evaluating the proposed merger and how it will affect you.

On behalf of the board of directors, I thank you for your prompt attention to this important matter.

Sincerely yours,

Frederick L. Hickman  
President and Chief Executive Officer

Neither the Securities and Exchange Commission nor any state securities commission or bank regulatory agency has approved or disapproved of the merger, the issuance of the Norwood common stock in connection with the merger or the other transactions described in this proxy statement/prospectus, or passed upon the adequacy or accuracy of the disclosure in this document. Any representation to the contrary is a criminal offense.

The securities to be issued in the merger are not savings accounts, deposits or other obligations of any bank or savings association and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency.

This proxy statement/prospectus is dated \_\_\_\_\_, 2011, and is first being mailed to shareholders of North Penn on or about \_\_\_\_\_, 2011.

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NORTH PENN BANCORP, INC.  
216 Adams Avenue  
Scranton, Pennsylvania 18503  
(570) 344-6113

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NOTICE OF SPECIAL MEETING OF SHAREHOLDERS  
To Be Held On \_\_\_\_\_, 2011

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NOTICE IS HEREBY GIVEN, that a special meeting of shareholders of North Penn Bancorp, Inc. will be held at \_\_\_\_\_, located at \_\_\_\_\_, \_\_\_\_\_, Pennsylvania, on \_\_\_\_\_, \_\_\_\_\_, 2011 at \_\_\_\_\_ a.m., local time, for the following purposes:

1. To consider and vote upon a proposal to adopt the Agreement and Plan of Merger, dated December 14, 2010, by and among Norwood Financial Corp., Wayne Bank, North Penn Bancorp, Inc. and North Penn Bank, under which North Penn will merge with and into Norwood;
2. To consider and vote upon a proposal to adjourn, postpone or continue the special meeting, if necessary, to permit further solicitation of proxies in favor of adopting the merger agreement; and
3. To transact such business as may properly come before the special meeting or any adjournment, postponement or continuance thereof.

Shareholders of record at the close of business on \_\_\_\_\_, 2011 are entitled to notice of and to vote at the special meeting and at any adjournment or postponement thereof. The enclosed proxy statement/prospectus describes the merger agreement in detail, and a copy of the merger agreement is annexed as Annex A to the proxy statement/prospectus and incorporated by reference therein.

The board of directors of North Penn unanimously recommends that North Penn's shareholders vote "FOR" the proposal to approve the merger agreement and "FOR" the adjournment proposal described above.

Your vote is very important. Your proxy is being solicited by the board of directors of North Penn. The proposal to approve the merger agreement must be approved by the affirmative vote of a majority of the votes cast at the special meeting; provided, that a majority of the outstanding shares of North Penn common stock entitled to vote at the special meeting is present, in person or by proxy. Whether or not you expect to attend the special meeting, please complete, sign and date the accompanying proxy card and return it in the enclosed postage prepaid envelope. You may revoke your proxy either by written notice to North Penn, by submitting a proxy card dated as of a later date or by voting in person at the special meeting.

Under Pennsylvania law, if the merger is completed, North Penn shareholders of record who do not vote to approve the merger agreement and otherwise comply with the applicable provisions of Pennsylvania law pertaining to dissenters' rights will be entitled to exercise dissenters' rights and obtain payment in cash of the fair value of their shares of North Penn common stock by following the procedures set forth in detail in the enclosed proxy statement/prospectus. A copy of the section of the Pennsylvania Business Corporation Law pertaining to dissenters' rights is included as Annex C to the accompanying proxy statement/prospectus.

By Order of the Board of Directors

Frank H. Mechler  
Secretary

If you have any questions or need assistance voting your shares, please contact our proxy solicitor, Regan & Associates, Inc., toll-free at [                      ].

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### WHERE YOU CAN FIND MORE INFORMATION

This document, which is sometimes referred to as this “proxy statement/prospectus” constitutes a proxy statement of North Penn with respect to the solicitation of proxies for the North Penn special meeting and a prospectus of Norwood for the shares of common stock that Norwood will issue to North Penn’s shareholders in the Merger.

Norwood filed a registration statement on Form S-4 to register with the Securities and Exchange Commission (or the “SEC”) the shares that Norwood will issue to North Penn’s shareholders in the merger. This proxy statement/prospectus constitutes a part of that registration statement on Form S-4. For further information about Norwood, you should review the registration statement filed with the SEC.

Norwood and North Penn file annual, quarterly and current reports, proxy statements and other information with the SEC required to be filed by them as reporting companies under Sections 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). You may read and copy any materials that Norwood and North Penn file with the SEC at the SEC’s Public Reference Room, 100 F Street, N.E., Washington, D.C. 20549 on official business days during the hours of 10:00 a.m. to 3:00 p.m. You should call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. In addition, the SEC maintains an Internet site at [www.sec.gov](http://www.sec.gov) that contains the reports, proxy and information statements, and other information that Norwood and North Penn file with the SEC. You may also obtain free copies of the documents that (i) Norwood files with the SEC by going to the Stockholder Services section of Norwood’s website, [www.waynebank.com](http://www.waynebank.com) or by contacting William S. Lance, Senior Vice President and Chief Financial Officer, Norwood Financial Corp., 717 Main Street, Honesdale, Pennsylvania 18431, Telephone: (570) 253-1455, and (ii) North Penn files with the SEC by going to the Investor Relations section of North Penn’s website, [www.northpennbank.com](http://www.northpennbank.com) or by contacting Bridget Orue, Assistant Secretary, North Penn Bancorp, Inc., 216 Adams Avenue, Scranton, Pennsylvania 18503, Telephone: (570) 344-6113. Information contained on Norwood’s and North Penn’s website is not incorporated into this proxy statement/prospectus and you should not consider information contained on either website to be part of this proxy statement/prospectus or any supplement thereto.

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NORWOOD MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
BUSINESS OF NORTH PENN

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ANNEXES

- A. Agreement and Plan of Merger, dated as of December 14, 2010, by and among  
Norwood Financial Corp., Wayne Bank, North Penn Bancorp, Inc.  
and North Penn Bank
  - B. Opinion of The Kafafian Group
  - C. Pennsylvania Business Corporation Law, Subchapter D of Chapter 15
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## QUESTIONS AND ANSWERS ABOUT THE MERGER AND THE SPECIAL MEETING

The following are answers to certain questions that you may have regarding the merger and the special meeting. We urge you to read carefully the remainder of this proxy statement/prospectus because the information in this section may not provide all the information that might be important to you in determining how to vote. Additional important information is also contained in the annexes to this proxy statement/prospectus.

Q: Why am I receiving this document?

A: Norwood and North Penn have agreed to combine under the terms of a merger agreement that is described in this proxy statement/prospectus. A copy of the merger agreement is attached to this proxy statement/prospectus as Annex A. In order to complete the merger, North Penn shareholders must vote to approve the merger agreement and the merger. North Penn is holding a special meeting of shareholders to obtain this approval. This proxy statement/prospectus contains important information about the merger, the merger agreement, the special meeting, and other related matters, and you should read it carefully.

Q: What will happen to North Penn as a result of the merger?

A: If the merger is completed, North Penn will merge with and into Norwood and its separate corporate existence will end. In addition, following the merger, North Penn Bank will merge with and into Wayne Bank with Wayne Bank being the surviving bank.

Q: What will North Penn shareholders receive in the merger?

A: If the merger agreement is approved and the merger is subsequently completed, each outstanding share of North Penn common stock (other than any dissenting shares) will be converted into the right to receive either:

- \$19.12 in cash, without interest; or
- 0.6829 of a share of Norwood common stock,

in each case, subject to adjustment, election and allocation procedures specified in the merger agreement.

Shareholders may elect to receive all cash, all stock, or cash for some shares and stock for the remainder of the shares they own, subject to adjustment, election and allocation procedures specified in the merger agreement. The ability to receive all stock, all cash or the allocation of both will depend on the elections of other North Penn shareholders. The allocation of the mix of consideration payable to North Penn shareholders in the merger will not be known until Norwood tallies the results of the cash/stock elections made by North Penn shareholders, which will not occur until near or after the closing of the merger. No guarantee can be made that you will receive the amounts of cash or stock that you elect. See “The Merger and the Merger Agreement – Consideration to be Received in the Merger” beginning on page 51 and “-- Allocation Procedures” beginning on page 54.

Q: Will North Penn shareholders receive the form of consideration they elect?

A: Each North Penn shareholder may not receive the form of consideration that it elects in the merger. The allocation procedures in the merger agreement are intended to provide that the aggregate amount of cash paid as cash consideration, in settlement of outstanding stock options, for unallocated



shares held by the North Penn Bank Employee Stock Ownership Plan (the “ESOP”) and for any dissenting shares equal \$12,194,000 (the “Aggregate Cash Consideration”). Pursuant to this limitation, if the aggregate number of shares with respect to which a valid cash consideration election is made multiplied by \$19.12, together with amounts paid in settlement of stock options, unallocated shares held by the ESOP and any dissenting shares, is greater than the Aggregate Cash Consideration, a pro rata portion of those shares will be converted into the right to receive Norwood common stock in order to provide for the anticipated mix between cash and stock. Similarly, if the number of shares pursuant to which a valid cash consideration election multiplied by \$19.12, together with amounts paid in settlement of stock options, for unallocated shares held by the ESOP, and for any dissenting shares is less than the Aggregate Cash Consideration, shares for which no election has been made first and shares for which a stock consideration election has been made will be converted, as necessary, such that the amount of cash paid out in the transaction is \$12,194,000. The allocation of the mix of consideration payable to North Penn shareholders in the merger will not be known until Norwood tallies the results of the cash/stock elections made by North Penn shareholders, which will not occur until near or after the closing of the merger. See “The Merger and the Merger Agreement – Consideration to be Received in the Merger” beginning on page 51 and “-- Allocation Procedures” beginning on page 54.

Q: How do North Penn shareholders register their election to cash, Norwood common stock or a combination thereof?

A: Each North Penn shareholder should complete and return an election form, along with North Penn stock certificate(s), according to the instructions included with the form. The election form will be provided to North Penn shareholders under separate cover. The election deadline will be 5:00 p.m., New York time, on the date specified in the election form. If you own shares of North Penn common stock in “street name” through a bank, broker or other financial institution and you wish to make an election, you should seek instructions from the financial institution holding your shares concerning how to make an election. If you do not send in the election form with your stock certificate(s) by the election deadline, you will be treated as though you had not made an election.

Q: What happens if a North Penn shareholder does not make a valid election as to whether to receive cash or stock?

A: If a North Penn shareholder does not return a properly completed election form by the election deadline specified in the election form, such shareholder’s shares of North Penn common stock will be considered “non-election shares” and will be converted into the right to receive the stock consideration or the cash consideration according to the allocation procedures specified in the merger agreement.

Q: When will the merger be completed?

A: We expect the merger will be completed when all of the conditions to completion contained in the merger agreement are satisfied or waived, including the receipt of required regulatory approvals and the approval of the merger agreement by North Penn shareholders at the special meeting. We currently expect to complete the merger during the second calendar quarter of 2011. However, because fulfillment of some of the conditions to completion of the merger, such as the receipt of required regulatory approvals, is not entirely within our control, we cannot predict the actual timing.

Q: What happens if the merger is not completed?

A: If the merger is not completed, North Penn shareholders will not receive any consideration for their shares of common stock in connection with the merger. Instead, North Penn will remain an independent public company and its common stock will continue to be quoted on the OTC Bulletin Board. Under specified circumstances, North Penn may be required to pay to Norwood a fee with respect to the termination of the merger agreement, as described under “The Merger and the Merger Agreement -- Termination Fee” beginning on page 73.

Q: Who is being asked to approve matters in connection with the merger?

A: North Penn shareholders are being asked to vote to approve the merger agreement and the merger and to approve a proposal to adjourn the special meeting, if necessary, to solicit additional proxies. No approval of Norwood shareholders is required. Under Pennsylvania law, the merger cannot be completed unless North Penn shareholders vote to adopt the merger agreement and the merger. By this proxy statement/prospectus, North Penn’s board of directors is soliciting proxies of North Penn shareholders to provide this approval at the special meeting of North Penn shareholders discussed below.

Q: Should North Penn shareholders send in their stock certificates now?

A: No. North Penn shareholders SHOULD NOT send in any stock certificates now. An election form and transmittal materials, with instructions for their completion, will be provided to North Penn shareholders under separate cover and the stock certificates should be sent at that time.

Q: What are the material United States federal income tax consequences of the merger to North Penn shareholders?

A: Norwood and North Penn will not be required to complete the merger unless they receive legal opinions from their respective counsel to the effect that the merger will qualify as a tax-free reorganization for United States federal income tax purposes. Provided that the merger qualifies as a reorganization for United States federal income tax purposes, the specific tax consequences of the merger to a North Penn shareholder will depend upon the form of consideration such shareholder will receive in the merger.

The consequences of the merger to any particular shareholder will depend on that shareholder’s particular facts and circumstances. Accordingly, you are urged to consult your tax advisor to determine your tax consequences from the merger.

For a more detailed discussion of the material United States federal income tax consequences of the transaction, see “The Merger and the Merger Agreement -- Tax Consequences of the Merger” beginning on page 56.

Q: Are North Penn shareholders entitled to appraisal rights?

A: Yes. Under Pennsylvania law, record holders of North Penn common stock who submit a written demand and do not vote in favor of the proposal to adopt the merger agreement will be entitled to seek appraisal rights in connection with the merger, and if the merger is completed, obtain payment in cash equal to the fair value of their shares of North Penn common stock instead of the merger consideration. To exercise their appraisal rights, North Penn shareholders must strictly follow the procedures prescribed by Pennsylvania law. These procedures are summarized in this proxy statement/prospectus. In addition, the text of the applicable provisions of Pennsylvania law is included as





Annex C to this document. Failure to strictly comply with these provisions will result in the loss of appraisal rights. For a more complete description of appraisal rights, please refer to the section entitled "The Merger and the Merger Agreement – Dissenters' Rights of Appraisal" beginning on page 74.

Q: Are there any risks that I should consider in deciding whether to vote for approval of the merger-related proposals?

A: Yes. You should read and carefully consider the risk factors set forth in the section of this proxy statement/prospectus entitled "Risk Factors" beginning on page 17.

Q: When and where will North Penn shareholders meet?

A: North Penn will hold a special meeting of its shareholders on \_\_\_\_\_, 2011, at \_\_:\_\_.m., Eastern Time, at \_\_\_\_\_, located at \_\_\_\_\_, \_\_\_\_\_, Pennsylvania \_\_\_\_\_.

Q: What matters are North Penn shareholders being asked to approve at the special meeting pursuant to the proxy statement/prospectus?

A: North Penn shareholders are being asked to adopt the merger agreement and approve the transactions contemplated by the merger agreement, including the merger. North Penn shareholders also are being asked to approve a proposal to adjourn, postpone or continue the special meeting, if necessary, to solicit additional proxies in favor of adoption of the merger agreement.

Q: What does North Penn's Board of Directors recommend with respect to the proposals?

A: North Penn's board of directors has unanimously approved the merger agreement and determined that the merger agreement and the merger are fair to and in the best interests of North Penn and its shareholders and unanimously recommends that North Penn shareholders vote "FOR" the merger agreement and "FOR" the adjournment proposal.

Q: Did the Board of Directors of North Penn receive an opinion from a financial advisor with respect to the merger?

A: Yes. On December 14, 2010, The Kafafian Group, which we refer to in this proxy statement/prospectus as "TKG," rendered its oral opinion to the board of directors of North Penn, subsequently confirmed in writing, that, as of such date and based upon and subject to the factors and assumptions described to the North Penn board during its presentation and set forth in the opinion, the consideration in the proposed merger was fair, from a financial point of view, to holders of North Penn common stock. The full text of TKG's written opinion is attached as Annex B to this proxy statement/prospectus. North Penn shareholders are urged to read the opinion in its entirety.

Q: Who can vote at the special meeting?

A: Holders of record of North Penn common stock at the close of business on \_\_\_\_\_, 2011, which is the record date for the special meeting, are entitled to vote at the special meeting.

Q: How many votes must be represented in person or by proxy at the special meeting to have a quorum?

A: The holders of a majority of the shares of North Penn common stock outstanding and entitled to vote at the special meeting, present in person or represented by proxy, will constitute a quorum at the special meeting.

Q: What vote by shareholders is required to approve each of the proposals?

A: Assuming a quorum is present at the special meeting, approval of the merger agreement will require the affirmative vote of the holders of a majority of the votes cast at the special meeting. Approval of the adjournment proposal will require the affirmative vote of a majority of the votes cast at the special meeting assuming a quorum is present. Abstentions and broker non-votes will have no effect on voting for or against the merger agreement proposal or the adjournment proposal.

As of the record date for the special meeting, directors and executive officers of North Penn, together with their affiliates, had sole or shared voting power over approximately \_\_\_\_% of the North Penn common stock outstanding and entitled to vote at the special meeting.

Q: How may the North Penn shareholders vote their shares for the proposals being presented at the special meeting?

A: North Penn shareholders may vote by completing, signing, dating and returning the proxy card in the enclosed prepaid return envelope as soon as possible. This will enable their shares to be represented and voted at the special meeting.

Q: Will a broker or bank holding shares in "street name" for a North Penn shareholder automatically vote those shares for a shareholder at the special meeting?

A: No. A broker or bank WILL NOT be able to vote your shares with respect to the North Penn merger agreement proposal without first receiving instructions from you on how to vote. If your shares are held in "street name," you will receive separate voting instructions with your proxy materials. It is therefore important that you provide timely instruction to your broker or bank to ensure that all shares of North Penn common stock that you own are voted at the special meeting.

Q: Will North Penn shareholders be able to vote their shares in person at the Special Meeting?

A: Yes. Submitting a proxy will not affect the right of any North Penn shareholder to vote in person at the special meeting. However, if a North Penn shareholder holds shares in "street name," the shareholder must first ask its broker or bank how to vote those shares in person at the special meeting and obtain a "legal proxy."

Q: What do North Penn shareholders need to do now?

A: After carefully reading and considering the information contained in this proxy statement/prospectus, please vote your shares promptly. If you hold your shares of North Penn common stock as a shareholder of record, you should complete, sign, date and promptly return the enclosed proxy card. The proxy card will instruct the persons named on the proxy card to vote your North Penn shares at the special meeting as you direct. If you sign and send in a proxy card and do not indicate how you wish to vote, the proxy will be voted "FOR" the special meeting proposals. If you hold your stock in "street



name” through a bank or broker, you must direct your bank or broker to vote in accordance with the instructions you have received from your bank or broker. Submitting your proxy card or directing your bank or broker to vote your shares will ensure that your shares are represented and voted at the special meeting.

Q: What should a North Penn shareholder do if he or she receives more than one set of voting materials?

A: As a North Penn shareholder, you may receive more than one set of voting materials, including multiple copies of this proxy statement/prospectus and multiple North Penn proxy cards or voting instruction cards. For example, if you hold your North Penn shares in more than one brokerage account, you will receive a separate voting instruction card for each brokerage account in which you hold North Penn shares. If you are a holder of record and your North Penn shares are registered in more than one name, you will receive more than one proxy card. Please complete, sign, date and return each proxy card and voting instruction card that you receive or otherwise follow the voting instructions set forth in this proxy statement/prospectus in the section entitled “The Special Meeting of Shareholders.”

Q: May a North Penn shareholder change or revoke the shareholder’s vote after revoking a proxy?

A: Yes. If you have not voted through your broker, you can change your vote by:

- providing written notice of revocation to the Corporate Secretary of North Penn, which must be filed with the Corporate Secretary by the time the special meeting begins;
- submitting a new proxy card (any earlier proxies will be revoked automatically); or
- attending the special meeting and voting in person. Any earlier proxy will be revoked. However, simply attending the special meeting without voting will not revoke your proxy.
- If you have instructed a broker to vote your shares, you must follow your broker’s directions to change your vote.

Q: What happens if I sell my shares of North Penn common stock before the special meeting?

A: The record date for North Penn shareholders entitled to vote at the special meeting is earlier than both the date of the special meeting and the completion of the merger. If you transfer your North Penn shares of common stock after the record date but before the special meeting, you will, unless special arrangements are made, retain your right to vote at the special meeting but will transfer the right to receive the merger consideration to the person to whom you transfer your shares.

Q: Who can help answer my questions?

A: If you have any questions about the merger or the special meeting, or if you need additional copies of this proxy statement/prospectus or the enclosed proxy card, you should contact our proxy solicitor, Regan & Associates, Inc. at \_\_\_\_\_.

## SUMMARY

This summary, together with the section of this proxy statement/prospectus entitled “Questions and Answers About the Merger and the Special Meeting” highlights selected information from this proxy statement/prospectus and may not contain all of the information that is important to you. To understand the merger fully, and for a more complete description of the legal terms of the merger, you should carefully read this entire proxy statement/prospectus, the annexes attached to this proxy statement/prospectus and the documents which are referred to in this proxy statement/prospectus. The Agreement and Plan of Merger dated as of December 14, 2010 is attached as Annex A to this proxy statement/prospectus. We have included page references in parentheses to direct you to the appropriate place in this proxy statement/prospectus for a more complete description of the topics presented in this summary. The terms “we,” “us” and “our” refer to both Norwood and North Penn. This summary and the rest of this document contain forward-looking statements about events that are not certain to occur, and you should not place undue reliance on those statements. Please carefully read “Cautionary Statement Regarding Forward-Looking Information” on page 31 of this document.

### The Parties

Norwood Financial Corp.  
717 Main Street  
Honesdale, Pennsylvania 18431  
(570) 253-1455

Norwood Financial Corp. (“Norwood”), a Pennsylvania corporation, is the holding company for Wayne Bank. Wayne Bank is a Pennsylvania chartered commercial bank headquartered in Honesdale, Pennsylvania. Wayne Bank was originally chartered on February 17, 1870 as Wayne County Savings Bank. Wayne County Savings Bank changed its name to Wayne County Bank and Trust in December 1943. In September 1993, Wayne Bank adopted the name Wayne Bank. On March 29, 1996, Wayne Bank completed a holding company reorganization and became a wholly owned subsidiary of Norwood. Wayne Bank is an independent community bank with five offices in Wayne County, three offices in Pike County and three offices in Monroe County. It offers a wide variety of personal and business credit services and trust and investment products and real estate settlement services to the consumers, businesses, nonprofit organizations, and municipalities in each of the communities that it serves. Wayne Bank primarily serves the Pennsylvania counties of Wayne, Pike and Monroe, and to a much lesser extent, the counties of Lackawanna and Susquehanna. In addition, Wayne Bank operates eleven automated teller machines, one in each of its branch locations. Norwood’s common stock is traded on the Nasdaq Global Market under the symbol “NWFL.”

At September 30, 2010, Norwood had total assets of \$534.6 million, deposits of \$398.6 million, and stockholders’ equity of \$68.4 million.

North Penn Bancorp, Inc.  
216 Adams Avenue  
Scranton, Pennsylvania 18503  
(570) 344-6113

North Penn Bancorp, Inc., a Pennsylvania corporation, is the holding company for North Penn Bank, a Pennsylvania savings bank headquartered in Scranton, Pennsylvania. North Penn Bank operates five full-service locations in Northeast Pennsylvania. North Penn Bank conducts a community banking business, offering a variety of deposit and loan products to individuals and small businesses in its market area. North Penn’s common stock is quoted on the OTC Bulletin Board under the symbol “NPBP.OB.”



At September 30, 2010, North Penn had total assets of \$164.5 million, total deposits of \$136.5 million and total stockholders' equity of \$19.9 million.

#### The Merger and the Merger Agreement (page 36)

The terms and conditions of the merger are contained in the merger agreement, which is attached to this proxy statement/prospectus as Annex A. We encourage you to read this agreement carefully, as it is the legal document that governs the merger.

Under the terms of the merger agreement, North Penn will merge with and into Norwood with Norwood as the surviving entity of the merger. Immediately thereafter, North Penn Bank will merge with and into Norwood's wholly owned banking subsidiary Wayne Bank with Wayne Bank as the surviving entity of the bank merger.

#### Merger Consideration (page 51)

Under the terms of the merger agreement, North Penn shareholders (other than dissenting shareholders) have the opportunity to elect for each outstanding share of North Penn common stock they own to receive:

- \$19.12 in cash, without interest, which we refer to as the "cash consideration"; or
- 0.6829 of a share of Norwood common stock, which we refer to as the "stock consideration."

North Penn shareholders may also elect to receive the cash consideration for some of their shares of North Penn common stock and the stock consideration for the remainder. Elections will be subject to adjustment, election and allocation procedures specified in the merger agreement.

The allocation procedures are intended to provide that the amount of cash Norwood will expend in the merger which includes the aggregate number of shares for which it pays the cash consideration, the cash paid in settlement of outstanding options, the cash consideration paid for unallocated shares held by the ESOP as well as any amounts paid to dissenting shareholders will equal \$12,194,000. In the event the cash consideration pool is oversubscribed, North Penn shareholders who make a cash election will receive a mix of cash and stock consideration in the merger. In the event the stock consideration pool is oversubscribed, North Penn shareholders who make a stock election will receive a mix of cash and stock consideration in the merger. The allocation of the mix of consideration payable to North Penn shareholders in the merger will not be known until Norwood tallies the results of the cash/stock elections made by North Penn shareholders, which will not occur until near or after the closing of the merger.

#### Election Procedures; Surrender of Stock Certificates (page 53)

An election form and transmittal materials, with instructions for their completion, will be provided to North Penn shareholders of record as of \_\_\_\_\_, 2011 under separate cover. The election form entitles such shareholders to elect to receive cash, Norwood common stock, or to elect cash for some of their shares and stock for the remainder, or make no election with respect to the merger consideration. To make an effective election, a North Penn shareholder of record must submit a properly completed election form along with the stock certificate(s) to the exchange agent by the election deadline, which shall be as specified in the election form. North Penn shareholders are urged to carefully read and follow the instructions for completion of the election form and to submit the form in advance of the election deadline.





Effective Time of the Merger (page 66)

The merger will occur after the satisfaction of all the closing conditions, including the receipt of all regulatory and shareholder approval and after the expiration of all regulatory waiting periods. As of the date of this proxy statement/prospectus, the parties expect that the merger will be effective during the second calendar quarter of 2011. However, there can be no assurance as to when or if the merger will occur.

North Penn Special Meeting of Shareholders (page 34)

A special meeting of the shareholders of North Penn will be held at \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, Pennsylvania \_\_\_\_\_, at \_\_:\_\_ .m., Eastern Time, on \_\_\_\_\_, 2011, for the following purposes:

- to approve the proposal to adopt the merger agreement and approve the transactions contemplated by the merger agreement, including the merger;
- to approve a proposal to adjourn, postpone or continue the special meeting, if necessary, to permit further solicitation of proxies in favor of adopting the merger agreement; and
- to transact any other business which may properly come before the special meeting or any adjournment, postponement or continuance of the special meeting.

You can vote at the special meeting of North Penn shareholders if you owned North Penn common stock at the close of business on \_\_\_\_\_, 2011, the record date. On that date, there were \_\_\_\_\_ shares of North Penn common stock outstanding and entitled to vote, approximately \_\_\_\_\_% of which were owned and entitled to be voted by North Penn directors and executive officers and their affiliates. These individuals have entered into agreements with Norwood requiring them to vote all of these shares in favor of adoption of the merger agreement. You can cast one vote for each share of North Penn common stock you owned on that date.

In order to approve the proposal to adopt the merger agreement, assuming a quorum is present at the North Penn special meeting, the holders of at least a majority of the votes cast must be in favor of the proposal. In order to approve the adjournment proposal, if necessary, the holders of a majority of the votes cast in person or represented by proxy at the special meeting and entitled to vote must vote in favor of the proposal.

Recommendation of the North Penn Board of Directors and Reasons for the Merger (page 41)

The North Penn board of directors has unanimously determined that the merger agreement and the merger are fair to and in the best interests of North Penn and its shareholders and accordingly unanimously approved the merger agreement and recommends that North Penn shareholders vote “FOR” the adoption of the merger agreement.

In determining whether to approve the merger agreement and recommend adoption of the merger agreement to the North Penn shareholders, North Penn’s board considered the factors described under “Recommendation of the North Penn Board of Directors and Reasons for the Merger.”

Opinion of North Penn’s Financial Advisor (page 45 and Annex B)

On December 14, 2010, TKG rendered its oral opinion to the board of directors of North Penn, subsequently confirmed in writing, that, as of such date and based upon and subject to the factors and assumptions described to the North Penn board during its presentation and set forth in its written opinion, the consideration in the proposed merger was fair, from a financial point of view, to holders of North Penn common stock. The full text of TKG’s written opinion, which sets forth the assumptions made, matters considered and limits on the review undertaken in connection with the opinion, is attached as Annex B to this proxy statement/prospectus and is incorporated by reference herein. North Penn shareholders are urged to read the opinion in its entirety. TKG’s written opinion is addressed to the board of directors of North Penn, is directed only to the consideration in the merger and does not constitute a recommendation as to how any holder of North Penn common stock should vote with respect to the merger or any other matter.

Interests of North Penn Directors and Executive Officers in the Merger (page 61)

In considering the recommendation of the board of directors of North Penn to adopt the merger agreement, you should be aware that officers and directors of North Penn have employment and other compensation agreements or plans that give them interests in the merger that may be different from, or in addition to, their interests as North Penn shareholders. These interests and agreements include:

- employment agreements that provide for severance payments and other benefits following a change in control and a termination of employment by the employer for reasons other than cause, disability, retirement or death;
- addendums to the employment agreements entered into between Norwood and each of Mr. Hickman, Mr. Dziak and Mr. Byrne. In the addendum to his employment agreement, Mr. Hickman agreed, among other things, that the maximum change in control severance benefit under his employment agreement will be \$597,344. Mr. Dziak agreed, among other things, that he would not compete with Norwood or any of its subsidiaries for a period beginning on the effective date of the merger and ending on the later of four months following the date of the merger or three months following his termination of employment with Norwood. Mr. Byrne agreed that if he is an employee in good standing with Norwood as of the date that is one month following the effective date of the merger he would receive \$50,000 and if he is an employee in good standing with Norwood as of the date that is 12 months following the effective date of the merger he would receive \$30,000, that he would not compete with Norwood or any of its subsidiaries for a period beginning on the effective date of the merger and ending on the later of one year following the date of the merger or three months following his termination of employment with Norwood and certain other matters;



- reimbursement to Mr. Hickman if payments under the employment agreements or any other payments trigger liability under Sections 280G and 4999 of the Internal Revenue Code for an excise tax on “excess parachute payments;”
- the accelerated vesting of all outstanding unvested stock options held by North Penn directors and executive officers and the exchange of each of these stock options for the excess of the cash consideration over the per share exercise price of the respective option;
- the accelerated vesting of all outstanding unvested restricted shares of common stock held by North Penn directors and executive officers;
- the fact that one current director of North Penn will be appointed as a director of Norwood when the merger is completed;
- the fact that the current North Penn directors who are not otherwise eligible for a severance or change in control payment (other than the one appointed to the Norwood board) will be entitled to receive a retainer in the amount of \$1,000 per month for an 18 month period in exchange for their efforts in promoting the combined entity after the Effective Time of the merger; and
- rights of North Penn officers and directors to indemnification and directors’ and officers’ liability insurance.

These additional interests of North Penn’s executive officers and directors may create potential conflicts of interest and cause these persons to view the proposed transaction differently than you may view it as a shareholder.

North Penn’s board of directors was aware of these interests and took them into account, among other matters, in its decision to approve the merger agreement and the transactions contemplated thereby, including the merger. For information concerning these interests, please see the discussion under the caption “The Merger and the Merger Agreement — Interests of Certain Persons in the Merger,” commencing on Page 61.

#### Regulatory Approvals Required for the Merger (page 60)

Completion of the merger is subject to various regulatory approvals or waivers, including, in connection with the planned merger of our subsidiary banks following completion of the merger, the Federal Deposit Insurance Corporation (the “FDIC”) and the Pennsylvania Department of Banking. We have also requested a waiver from the Federal Reserve Board of its application requirement. We have completed, or will complete, filing all the required applications and notices with regulatory authorities. We also have made or will make filings with various other federal and state regulatory agencies and self-regulatory organizations, notifying, or requesting approval from, those agencies and organizations for or in connection with the merger and the bank merger. Although we currently believe we should be able to obtain all required regulatory approvals in a timely manner, we cannot be certain when or if we will obtain them or, if obtained, whether they will contain terms, conditions or restrictions not currently contemplated that will be detrimental to or have a material adverse effect on Norwood after the completion of the merger.

#### Conditions to the Merger (page 66)

Completion of the merger depends on a number of conditions being satisfied or waived, including the following:

- approval of the merger agreement by North Penn's shareholders;
- receipt of all required regulatory approvals and the expiration of all statutory waiting periods;
- there shall be no actual or threatened causes of action, investigations or proceedings (1) challenging the validity or legality of the merger agreement or the consummation of the merger, or (2) seeking damages in connection with the merger, or (3) seeking to restrain or invalidate the merger; unless actual or threatened causes of action, investigations or proceedings would not have a material adverse effect with respect to the interests of Norwood or North Penn, as the case may be;
- Norwood's registration statement of which this proxy statement/prospectus is a part being effective;
- no party to the merger being subject to any legal order, decree or injunction that prohibits consummating any part of the transaction, and the absence of any statute, rule or regulation that prohibits completion of any part of the transaction; and
- the other party having performed in all material respects its obligations under the merger agreement, the other party's representations and warranties being true and correct as of the effective date of the merger and receipt of a certificate signed by the other party's chief executive officer to that effect.

Norwood's obligations to consummate the merger are also conditioned on the following:

- there shall have been no determination by Norwood that any fact, event, or condition exists or has occurred that would have a material adverse effect on North Penn or the consummation of the transactions contemplated by the merger agreement;
- receipt by North Penn of all consents and approvals from third parties (other than those required from regulatory authorities) required to complete the merger, unless failure to obtain those consents or approvals would not have a material adverse effect on the merger or Norwood after completion of the merger;
- there shall be no action taken by a regulatory authority, which, in connection with approval of the merger, imposes, in the judgment of Norwood, any material adverse requirement upon Norwood or any Norwood subsidiary, including, without limitation, any requirement that Norwood sell or dispose of any significant amount of assets of North Penn, or any other Norwood subsidiary;

Although we anticipate that the closing will occur during the second calendar quarter of 2011, because the satisfaction of certain of these conditions is beyond our control, we cannot be certain when, or if, the conditions to the merger will be satisfied or waived or whether or not the merger will be completed.

No Solicitation; Board Recommendation (page 70)

North Penn has agreed not to initiate, solicit, encourage or knowingly facilitate any inquiries or proposals from any third party relating to an acquisition of North Penn, or engage in any negotiations concerning, or provide any confidential or nonpublic information or data to, or have any discussions with, any person relating to, any acquisition proposal. Notwithstanding these restrictions, the merger agreement provides that, under specified circumstances prior to shareholder approval of the merger agreement, in



response to an unsolicited bona fide acquisition proposal from a third party if, in the good faith judgment of the North Penn board of directors (after consultation with its legal counsel and financial advisor) (i) it is legally necessary for the proper discharge of its fiduciary duties to respond to such proposal and (ii) such proposal constitutes a “superior proposal” as compared to the terms of the merger with Norwood, North Penn may furnish information regarding North Penn and participate in discussions and negotiations with such third party. North Penn has agreed to submit the merger agreement for adoption by its shareholders. The North Penn board has recommended that its shareholders vote in favor of adopting the merger agreement and has agreed that it will not withdraw, qualify or adversely modify its recommendation to its shareholders to vote in favor of adoption of the merger agreement, except as permitted under the merger agreement in connection with an unsolicited superior acquisition proposal after giving effect to any adjustments that may be offered by Norwood.

Termination; Termination Fee (page 72)

Norwood and North Penn may mutually agree at any time to terminate the merger agreement without completing the merger, even if the North Penn shareholders have adopted the merger agreement in connection with the merger. The merger agreement may also be terminated and the merger abandoned at any time prior to the effective time of the merger, as follows:

- by the written mutual consent of Norwood and North Penn;
- by either party, if the shareholders of North Penn fail to approve the merger agreement;
- by either party, if a required regulatory approval, consent or waiver is denied;
- by either party, if the merger is not consummated by October 31, 2011 or other mutually agreed upon date, unless failure to complete the merger by that time is due to a breach of a representation, warranty or covenant by the party seeking to terminate the merger agreement;
- by either party, if the other party materially breaches any representation, warranty, covenant or agreement contained in the merger agreement, or in the event of an inaccuracy of any representation or warranty by the other party, in either case that has not been cured within 30 days following written notice to such party;
- by Norwood, if North Penn fails to hold its shareholder meeting to vote on the merger within the time frame set in the merger agreement;
- by Norwood, if the board of directors of North Penn does not recommend approval of the merger to the North Penn shareholders or withdraws or revises its recommendation in a manner adverse to Norwood;
- by North Penn, if prior the approval of the merger agreement by the shareholders of North Penn, it receives a superior proposal from a third party that, in the good faith determination of North Penn’s board of directors, the board is required to accept in order to comply with its fiduciary duties and Norwood does not make an offer at least as favorable to North Penn within 5 days after notice; or
- by North Penn, at any time during a 5 day period beginning on the date that all required regulatory approvals have been received (the “Determination Date”) if both of the following conditions are satisfied:





- o The average of the daily closing sales prices for the Norwood common stock for the 20 consecutive trading days immediately preceding the Determination Date (the “Norwood Market Value”) is less than \$22.40; and
- o The number obtained by dividing the Norwood Market Value by \$28.00 is less than the number obtained by dividing the average closing prices of the NASDAQ Bank Index for the 20 consecutive trading days immediately preceding the Determination Date divided by the NASDAQ Index Price on December 14, 2010 minus 0.20.

Unless within five business days of notice of such termination, Norwood notifies North Penn that it will increase the exchange ratio for the stock consideration so that the Norwood Market Value is equal to a dollar amount that is the lesser of \$22.40 or the amount obtained by reducing the Initial Norwood Market Value by the percentage change in the NASDAQ Bank Index less 20 percentage points.

North Penn may be required to pay to Norwood a termination fee of \$1.125 million in certain circumstances described under “Termination Fee” beginning on page 73.

Material United States Federal Income Tax Consequences of the Merger (page 56)

Norwood and North Penn will not be required to complete the merger unless they receive legal opinions from their respective counsel to the effect that the merger will qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code.

Provided that the merger qualifies as a reorganization for United States federal income tax purposes, the specific tax consequences of the merger to a North Penn shareholder will depend upon the form of consideration such North Penn shareholder receives in the merger.

- If you receive solely shares of Norwood common stock and cash instead of a fractional share of Norwood common stock in exchange for your North Penn common stock, then you generally will not recognize any gain or loss, except with respect to the cash received instead of a fractional share of Norwood common stock.
- If you receive solely cash, then you generally will recognize gain or loss equal to the difference between the amount of cash you receive and your cost basis in your North Penn common stock. Generally, any gain recognized upon the exchange will be capital gain, and any such capital gain will be long-term capital gain if you have established a holding period of more than one year for your shares of North Penn common stock.
- If you receive a combination of Norwood common stock and cash, other than cash instead of a fractional share of Norwood common stock, in exchange for your North Penn common stock, then you may recognize gain, but you will not recognize loss, upon the exchange of your shares of North Penn common stock for shares of Norwood common stock and cash. If the sum of the fair market value of the Norwood common stock and the amount of cash you receive in exchange for your shares of North Penn common stock exceeds the cost basis of your shares of North Penn common stock, you will recognize taxable gain equal to the lesser of the amount of such excess or the amount of cash you receive in the exchange. Generally, any gain recognized upon the exchange will be capital gain, and any such capital gain will be long-term capital gain if you have established a holding period of more than one year for your shares of North Penn



common stock. Depending on certain facts specific to you, any gain could instead be characterized as ordinary dividend income.

For a more detailed discussion of the material United States federal income tax consequences of the transaction, see “The Merger and the Merger Agreement -- Tax Consequences of the Merger” beginning on page 56.

The consequences of the merger to any particular shareholder will depend on that shareholder’s particular facts and circumstances. Accordingly, you are urged to consult your tax advisor to determine your tax consequences from the merger.

#### Stock Market Listing (page 66)

Application will be made by Norwood to have the shares of Norwood common stock to be issued in the merger approved for listing on the NASDAQ Global Market, which is the principal trading market for existing shares of Norwood common stock. It is a condition to both parties’ obligation to complete the merger that such approval be obtained, subject to official notice of issuance.

#### Comparison of Shareholders’ Rights (page 81)

The rights of North Penn shareholders who continue as Norwood shareholders after the merger will be governed by the articles of incorporation and bylaws of Norwood rather than by the articles of incorporation and bylaws of North Penn.

#### Appraisal Rights (page 74 and Annex C)

North Penn is organized under Pennsylvania law. Under applicable Pennsylvania law, any North Penn shareholder is entitled to dissent from the merger and obtain payment of the judicially determined “fair value” of his or her shares of North Penn common stock. The judicially determined “fair value” could be more or less than the merger consideration. If you wish to dissent from the merger:

- you must submit a written demand to North Penn before the vote upon the merger agreement at the special meeting, and
- you may not vote in favor of the merger agreement.

In submitting your written demand, you must follow the procedures set forth in Subchapter D of Chapter 15 of the Pennsylvania Business Corporation Law of 1988, a copy of which is attached as Annex C to this proxy statement/prospectus.

#### Comparative Market Prices and Share Information (page 32)

Norwood common stock is traded on the Nasdaq Global Market under the symbol “NWFL”. North Penn common stock is quoted on the OTC Bulletin Board the symbol “NPBP.” The following table shows the last closing sale prices of Norwood common stock as reported on the Nasdaq Global Market and the last closing sales prices of the North Penn common stock as reported on the OTC Bulletin Board respectively, as of December 14, 2010, the last trading day before we announced the merger, and on \_\_\_\_\_, 2011, the latest practicable date prior to mailing this proxy statement/prospectus. The table also presents the equivalent value of the merger consideration per share of North Penn common stock on December 14, 2010 and \_\_\_\_\_, 2011. The equivalent value per share of North Penn common stock on such dates is calculated by multiplying the closing price of Norwood common stock on those

dates by 0.6829, which represents the number of shares of Norwood

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common stock that North Penn shareholders electing to receive Norwood common stock would receive in the merger for each share of North Penn common stock.

	Norwood Common Stock	North Penn Common Stock	North Penn Equivalent Per Share Value
At December 14, 2010	\$ 28.73	\$ 10.90	\$ 19.62
At _____, 2011	\$	\$	\$

The market price of Norwood common stock and North Penn common stock will fluctuate prior to the merger. You should obtain current stock price quotations for the shares.

## RISK FACTORS

In addition to the other information contained in this proxy statement/prospectus, including the matters addressed under the caption “Cautionary Statement Regarding Forward-Looking Statements,” North Penn shareholders should carefully consider the following risk factors in deciding whether to vote for adoption of the merger agreement. You should also consider the other information in this proxy statement/prospectus. See “Where You Can Find More Information” in the forefront of this proxy statement/prospectus.

### Risks Related to the Merger

#### North Penn Shareholders May Not Receive the Form of Merger Consideration They Elect.

The merger agreement contains provisions relating to adjustment, election and allocation of the merger consideration under certain circumstances. The allocation procedures are intended to provide that aggregate amount of cash paid by Norwood in the merger will equal \$12,194,000. Cash paid in settlement of outstanding stock options, in exchange for unallocated shares held by the ESOP and for any dissenting shares counts towards this cash limitation.

Norwood common stock may be issued to North Penn shareholders who make cash elections if the cash consideration pool is oversubscribed, so that aggregate cash consideration payable to North Penn shareholders in the merger will equal \$12,194,000. Similarly, cash may be paid to North Penn shareholders who make stock elections if the cash consideration pool is undersubscribed so that the aggregate cash paid in the merger will equal \$12,194,000. In addition, the aggregate cash consideration pool may be decreased, and the aggregate stock consideration pool may be increased, in order for the merger to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code.

Since the cash consideration will be paid for only approximately 45% of the North Penn shares outstanding at the effective time of the merger, it is possible that the cash consideration pool will be oversubscribed and North Penn shareholders who elect to receive cash consideration will receive a mix of cash and stock consideration in the merger. It is also possible that the cash consideration pool could be undersubscribed and that North Penn shareholders who elect to receive stock consideration will receive a mix of cash and stock in exchange for their shares. The allocation of the mix of consideration payable to North Penn shareholders in the merger will not be known until Norwood tallies the results of the cash/stock elections made by North Penn shareholders, which will not occur until near or after the closing of the merger. North Penn shareholders may not receive the amounts of cash or stock they elected. Accordingly, if there is an oversubscription of cash or an oversubscription of stock, it is likely that North Penn shareholders will not receive a portion of the merger consideration in the form that they elect, which could result in, among other things, tax consequences that differ from those that would have resulted had such shareholders received the form of consideration they elected.

#### Because the Market Price of Norwood Common Stock May Fluctuate, North Penn Shareholders Cannot be Sure of the Value of the Stock Consideration They May Receive.

North Penn shareholders may elect to receive cash, stock or mixed consideration in the merger. The exchange ratio of 0.6829 of a share of Norwood common stock per share of North Penn common stock at which Norwood is issuing its shares as part of the merger consideration is fixed (subject to customary anti-dilution adjustments and potential adjustment in certain circumstances involving a decline in Norwood’s stock price that exceeds a specified index).





Consequently, changes in the price of Norwood common stock prior to completion of the merger will affect the value of any shares of Norwood common stock North Penn shareholders may receive upon completion of the merger. The value of the Norwood stock consideration will vary from the date of the announcement of the merger agreement, the date that this proxy statement/prospectus was mailed, the date of the special meeting and the date the merger is completed and thereafter. At the time that the merger is completed, the value of the stock consideration could be more or less than the value of the cash consideration. Accordingly, at the time of the special meeting, you will not know or be able to determine the value of the Norwood common stock you may receive upon completion of the merger. Stock price changes may result from a variety of factors, including general market and economic conditions, changes in the respective businesses, operations and prospects, and regulatory considerations of Norwood and North Penn. Many of these factors are beyond Norwood's and North Penn's control.

**North Penn Shareholders Who Make Elections May Be Unable to Sell Their Shares in the Market Pending the Merger.**

North Penn shareholders may elect to receive cash, stock or mixed consideration in the merger by completing an election form that will be sent under separate cover. Elections will require that shareholders making the election turn in their North Penn stock certificates. This means that during the time between when the election is made and the date the merger is completed, North Penn shareholders will be unable to sell their North Penn common stock. If the merger is unexpectedly delayed, this period could extend for a significant period of time. North Penn shareholders can shorten the period during which they cannot sell their shares by delivering their election shortly before the election deadline. However, elections received after the election deadline will not be accepted or honored.

**North Penn Shareholders Will Have a Reduced Ownership and Voting Interest After the Merger and Will Exercise Less Influence Over Management.**

North Penn shareholders currently have the right to vote in the election of the board of directors of North Penn and on other matters affecting North Penn. Upon the completion of the merger, each North Penn shareholder who receives shares of Norwood common stock will become a shareholder of Norwood with a percentage ownership of Norwood that is smaller than the shareholder's percentage ownership of North Penn. It is currently expected that the former shareholders of North Penn as a group will receive shares in the merger constituting approximately 6.2% of the outstanding shares of Norwood common stock immediately after the merger. Because of this, North Penn shareholders may have less influence on the management and policies of Norwood than they now have on the management and policies of North Penn.

**Norwood May Fail to Realize the Anticipated Benefits of the Merger.**

The success of the merger will depend on, among other things, Norwood's ability to realize anticipated cost savings and to combine the businesses of Wayne Bank and North Penn Bank in a manner that permits growth opportunities and does not materially disrupt the existing customer relationships of North Penn Bank nor result in decreased revenues due to any loss of customers. If Norwood is not able to successfully achieve these objectives, the anticipated benefits of the merger may not be realized fully or at all or may take longer to realize than expected.

Norwood and North Penn have operated and, until the completion of the merger, will continue to operate, independently. Certain employees of North Penn may not be employed after the merger. In addition, employees of North Penn that Norwood wishes to retain may elect to terminate their employment as a result of the merger, which could delay or disrupt the integration process. It is possible that the integration process could result in the disruption of Norwood's or North Penn's ongoing



businesses or cause inconsistencies in standards, controls, procedures and policies that adversely affect the ability of Norwood or North Penn to maintain relationships with customers and employees or to achieve the anticipated benefits of the merger.

Regulatory Approvals May Not Be Received, May Take Longer than Expected or May Impose Conditions that Are Not Presently Anticipated or Cannot Be Met.

Before the transactions contemplated in the merger agreement, including the merger, may be completed, various approvals must be obtained from the bank regulatory and other governmental authorities. These governmental entities may impose conditions on the completion of the merger or require changes to the terms of the merger agreement. Although the parties do not currently expect that any such conditions or changes would be imposed, such conditions or changes may be imposed, and such conditions or changes could have the effect of delaying completion of the transactions contemplated in the merger agreement or imposing additional costs on or limiting Norwood's revenues, any of which might have a material adverse effect on Norwood following the merger. In addition, the regulatory approvals may not be received at any time, may not be received in a timely fashion, and may contain conditions on the completion of the merger.

The Merger Agreement May Be Terminated in Accordance with Its Terms and the Merger May Not Be Completed.

The merger agreement is subject to a number of conditions which must be fulfilled in order to complete the merger. Those conditions include: approval of the merger agreement by North Penn shareholders, regulatory approvals, absence of orders prohibiting the completion of the merger, effectiveness of the registration statement of which this proxy statement/prospectus is a part, approval of the shares of Norwood common stock to be issued to North Penn shareholders for listing on the NASDAQ Global Market, the continued accuracy of the representations and warranties by both parties and the performance by both parties of their covenants and agreements, and the receipt by both parties of legal opinions from their respective tax counsels.

In addition, certain circumstances exist whereby North Penn may choose to terminate the merger agreement, including if Norwood's share price declines to below \$22.40 (subject to customary anti-dilution adjustments) as of the first date when all regulatory approvals for the merger have been received, combined with such decline being at least 20% greater than a corresponding decline in the value of the NASDAQ Bank Index, and no adjustment pursuant to a specified formula is made to the exchange ratio by Norwood. See "The Merger and the Merger Agreement -- Terminating the Merger Agreement" beginning on page 72 for a more complete discussion of the circumstances under which the merger agreement could be terminated. Therefore, the conditions to closing of the merger may not be fulfilled and the merger may not be completed.

Termination of the Merger Agreement Could Negatively Impact North Penn.

If the merger agreement is terminated, there may be various consequences, including:

- North Penn's businesses may have been adversely impacted by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the merger; and
  - the market price of North Penn common stock might decline to the extent that the current market price reflects a market assumption that the merger will be completed.



If the merger agreement is terminated and North Penn's board of directors seeks another merger or business combination, North Penn shareholders cannot be certain that North Penn will be able to find a party willing to offer equivalent or more attractive consideration than the consideration Norwood has agreed to provide in the merger.

If the merger agreement is terminated under certain circumstances, North Penn may be required to pay a termination fee of \$1.125 million to Norwood. See "The Merger and the Merger Agreement -- Termination Fee" beginning on page 73.

Norwood Will Be Subject to Business Uncertainties and Contractual Restrictions While the Merger is Pending.

Uncertainty about the effect of the merger on employees and customers may have an adverse effect on North Penn and consequently on Norwood. These uncertainties may impair North Penn's ability to attract, retain and motivate key personnel until the merger is completed, and could cause customers and others that deal with North Penn to seek to change existing business relationships with North Penn. Retention of certain employees may be challenging during the pendency of the merger, as certain employees may experience uncertainty about their future roles. If key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with the business, Norwood's business following the merger could be negatively impacted. In addition, the merger agreement restricts North Penn from making certain acquisitions and taking other specified actions until the merger occurs without the consent of Norwood. These restrictions may prevent North Penn from pursuing attractive business opportunities that may arise prior to the completion of the merger. See "The Merger and the Merger Agreement -- Conduct of Business Before the Merger" beginning on page 67 for a description of the restrictive covenants to which North Penn is subject.

The Merger Agreement Limits North Penn's Ability to Pursue Alternatives to the Merger.

The merger agreement contains "no-shop" provisions that, subject to limited exceptions, limit North Penn's ability to initiate, solicit, encourage or knowingly facilitate any inquiries or competing third-party proposals, or engage in any negotiations, or provide any confidential information, or have any discussions with any person relating to a proposal to acquire all or a significant part of North Penn. In addition, North Penn has agreed to pay Norwood a termination fee in the amount of \$1.125 million in the event that Norwood or North Penn terminates the merger agreement for certain reasons. These provisions might discourage a potential competing acquiror that might have an interest in acquiring all or a significant part of North Penn from considering or proposing that acquisition even if it were prepared to pay consideration with a higher per share market price than that proposed in the merger, or might result in a potential competing acquiror proposing to pay a lower per share price to acquire North Penn than it might otherwise have proposed to pay. Until the merger agreement is approved by North Penn shareholders, North Penn can consider and participate in discussions and negotiations with respect to an alternative unsolicited bona fide acquisition proposal (subject to its obligation to pay a termination fee under certain circumstances) so long as the North Penn board of directors determines in good faith (after consultation with legal counsel and its financial advisor) that it is legally necessary to do so to comply with its fiduciary duties to North Penn shareholders under Pennsylvania law and that such alternative acquisition proposal constitutes a superior proposal. North Penn has agreed to keep Norwood apprised of developments, discussions and negotiations relating to any such acquisition proposal.

North Penn Directors and Officers May Have Interests in the Merger Different from the Interests of North Penn Shareholders.



The interests of some of the directors and executive officers of North Penn may be different from those of North Penn shareholders, and directors and officers of North Penn may be participants in arrangements that are different from, or are in addition to, those of North Penn shareholders. These interests are described in more detail in the section of this proxy statement/prospectus entitled “Interests of Certain Persons in the Merger” beginning on page 61.

The Shares of Norwood Common Stock to Be Received by North Penn Shareholders as a Result of the Merger Will Have Rights Different from the Shares of North Penn Common Stock.

Upon completion of the merger, the rights of former North Penn shareholders who become Norwood shareholders will be governed by the articles of incorporation and bylaws of Norwood. The rights associated with North Penn common stock are different from the rights associated with Norwood common stock. See “Comparison of Shareholders’ Rights” beginning on page 89 for a discussion of the different rights associated with Norwood common stock.

The Unaudited Pro Forma Combined Financial Information Included in this Proxy Statement/Prospectus Is Preliminary and the Actual Financial Condition and Results of Operations After the Merger May Differ Materially.

The unaudited pro forma combined financial information in this proxy statement/prospectus is presented for illustrative purposes only and is not necessarily indicative of what Norwood’s actual financial condition or results of operations would have been had the merger been completed on the dates indicated. The pro forma combined financial information reflects adjustments, which are based upon preliminary estimates, to record the North Penn identifiable assets acquired and liabilities assumed at fair value and the resulting goodwill recognized. The purchase price allocation reflected in this proxy statement/prospectus is preliminary, and final allocation of the purchase price will be based upon the actual purchase price and the fair value of the assets and liabilities of North Penn as of the date of the completion of the merger. Accordingly, the final acquisition accounting adjustments may differ materially from the pro forma adjustments reflected in this proxy statement/prospectus. For more information, see “Pro Forma Data” beginning on page 81.

The fairness opinion obtained by North Penn from its financial advisor will not reflect changes in circumstances subsequent to the date of the fairness opinion.

TKG, North Penn’s financial advisor in connection with the merger, has delivered to the board of directors of North Penn its opinion dated as of December 14, 2010. The opinion of TKG stated that as of such date, and based upon and subject to the factors and assumptions set forth therein, the merger consideration to be paid to the holders of the outstanding shares of North Penn common stock pursuant to the merger agreement was fair from a financial point of view to such holders. The opinion does not reflect changes that may occur or may have occurred after the date of the opinion, including changes to the operations and prospects of Norwood or North Penn, changes in general market and economic conditions or regulatory or other factors. Any such changes, or changes in other factors on which the opinion is based, may materially alter or affect the relative values of Norwood and North Penn.

#### Risks Related to Norwood’s Business

Norwood’s success will depend upon its ability to effectively manage its future growth.

Norwood believes that it has in place the management and systems, including data processing systems, internal controls and a strong credit culture, to support continued growth. However, its continued growth and profitability depend on the ability of its officers and key employees to manage such growth





effectively, to attract and retain skilled employees and to maintain adequate internal controls and a strong credit culture. Accordingly, there can be no assurance that Norwood will be successful in managing its expansion, and the failure to do so would adversely affect its financial condition and results of operations.

If Norwood experiences loan losses in excess of its allowance, its earnings will be adversely affected.

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

As of September 30, 2010, Norwood's allowance for loan losses was \$5.5 million which represented 1.54% of outstanding loans. At such date, Norwood had 15 nonperforming loans totaling \$3.7 million and eight impaired loans totaling \$13.3 million. Norwood actively manages its nonperforming loans in an effort to minimize credit losses. Although management of Norwood believes that its allowance for loan losses is adequate, there can be no assurance that the allowance will prove sufficient to cover future loan losses. Further, although management of Norwood uses the best information available to make determinations with respect to the allowance for loan losses, future adjustments may be necessary if economic conditions differ substantially from the assumptions used or adverse developments arise with respect to its non-performing or performing loans. Material additions to its allowance for loan losses would result in a decrease in its net income and capital, and could have a material adverse effect on its financial condition and results of operations and the value of its common stock.

Most of Norwood's loans are to commercial borrowers, which have a higher degree of risk than other types of loans.

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

Most of Norwood's loans are secured, in whole or in part, with real estate collateral which is subject to declines in value.

In addition to the financial strength and cash flow characteristics of the borrower in each case, Norwood often secures its loans with real estate collateral. As of September 30, 2010, approximately 89.1% of its loans, had real estate as a primary or secondary component of collateral. In addition, approximately 39.3% of its securities portfolio consisted of mortgage-backed securities issued by either Fannie Mae (FNMA), Freddie Mac (FHLMC) or Government National Mortgage Association (GNMA). Real estate values and real estate markets are generally affected by, among other things, changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies, and acts of nature. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower. If real estate prices in Norwood's markets decline, the value of the real estate collateral securing the loans could be reduced. If Norwood is required to liquidate the collateral securing a loan during a period of reduced real estate values to satisfy the debt, its earnings and capital could be adversely affected.

Norwood may be required to record other-than-temporary impairment charges in respect of its investment securities portfolio and restricted stock.

As of September 30, 2010, Norwood had approximately \$11.8 million in investments, including mortgage-backed securities on which it had unrealized losses of \$78,000. In addition, Norwood had \$3.5 million of restricted stock in the FHLB of Pittsburgh, which has suspended the payment of dividends and has limited its repurchases of excess capital stock. Norwood may be required to record impairment charges on its investments and FHLB stock if they suffer a decline in value that is considered other-than-temporary. Numerous factors, including lack of liquidity for resales of certain investment securities, absence of reliable pricing information for investment securities, adverse changes in the business climate, or adverse actions by regulators could have a negative effect on the value of the investments and mortgage backed securities. If an impairment charge is significant enough to result in a loss for the period, it could affect the ability of Wayne Bank to upstream dividends to Norwood, which could have a material adverse effect on its liquidity and ability to pay dividends to shareholders and could also negatively impact its regulatory capital ratios and result in it not being classified as "well capitalized" for regulatory purposes.

Higher FDIC deposit insurance premiums and assessments could adversely affect Norwood's earnings and financial condition.

FDIC insurance premiums increased substantially in 2009 and banks may be required to pay higher FDIC premiums in the future. The large number of bank failures has significantly depleted the Deposit Insurance Fund and reduced the ratio of reserves to insured deposits below the designated reserve ratio. To restore the deposit insurance fund, the FDIC adopted a revised risk-based deposit insurance assessment schedule, which significantly raised deposit insurance premiums on all insured banks. The FDIC also imposed a five basis point special assessment payable September 30, 2009 on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. In order to increase the funds available to the Deposit Insurance Fund, the FDIC required all insured depository institutions to prepay their federal deposit insurance assessments through 2012. The prepayment was based on the institution's assessment base and assessment rate as of September 30, 2009 assuming 5% annual growth in deposits and a three basis point increase in the assessment rate during years 2011 and 2012. The prepayment was recorded on the balance sheet as a non-earning prepaid expense asset against which future quarterly assessments will be charged.

Norwood also participates in the FDIC's Temporary Liquidity Guarantee Program which provides federal deposit insurance coverage for noninterest-bearing transaction deposit accounts in excess

of \$250,000. For this additional coverage, Norwood paid the FDIC an annual assessment of 10 basis points on the amounts in excess of \$250,000 during 2009. To the extent that these assessments are insufficient to cover any loss or expenses arising from the program, the FDIC is authorized to impose an emergency special assessment on all FDIC-insured depository institutions. After December 31, 2009, the fee for participation in transaction account guarantee program of the Temporary Liquidity Guarantee Program was increased to between 15 and 25 basis points, depending on the institution's risk category. These changes will cause Norwood's deposit insurance expense to increase and could significantly increase its noninterest expense in and for the foreseeable future.

The soundness of other financial institutions could adversely affect Norwood.

Norwood's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by Norwood or by other institutions. There is no assurance that any such losses would not materially and adversely affect its results of operations.

Recently enacted financial reform legislation could substantially increase Norwood's compliance burden and costs and necessitate changes in the conduct of its business.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law. The Dodd-Frank Act will have a broad impact on the financial services industry, including significant regulatory and compliance changes. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on Norwood's operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of its business activities, require changes to certain of its business practices, impose upon it more stringent capital, liquidity and leverage requirements or otherwise adversely affect its business. In particular, the following provisions of the Dodd-Frank Act, among others, are expected to impact Norwood's operations and activities, both currently and prospectively:

- The imposition of capital requirements on Norwood that are no less stringent than those applicable to Wayne Bank, which may reduce its flexibility in raising capital;
- Changes in methodologies for calculating deposit insurance premiums and increases in required deposit insurance fund reserve levels, which could increase its deposit insurance expense;
- Elimination of restrictions on interstate branching, which could allow more competitors to enter Norwood's market area; and
- Imposition of comprehensive, new consumer protection requirements, which could substantially increase its compliance burden and potentially expose it to new liabilities.

Further, Norwood may be required to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements under the Dodd-Frank Act. Failure to comply with the new requirements may negatively impact its results of operations and financial condition. While Norwood cannot predict what effect any presently contemplated



or future changes in the laws or regulations or their interpretations would have on it, these changes could be materially adverse to its investors.

Recent legislative and regulatory initiatives to address difficult market and economic conditions may not stabilize the U.S. banking system.

In response to this financial crisis affecting the banking system and financial markets, the United States Congress enacted the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009. Under these and other laws and government actions:

- the U.S. Department of the Treasury, or “Treasury,” has provided capital to financial institutions and adopted programs to facilitate and finance the purchase of problem assets and finance asset-backed securities via the Troubled Assets Relief Program, or “TARP”;
- the FDIC provided temporary liquidity guarantee, or “TLG”, of all FDIC-insured institutions and their affiliates’ debt, as well as deposits in noninterest-bearing transaction deposit accounts; and
- the federal government has undertaken various forms of economic stimulus, including assistance to homeowners in restructuring mortgage payments on qualifying loans.

TARP and the TLG are winding down, and the effects of this wind-down cannot be predicted. In addition, the federal government is considering various proposals for a comprehensive overhauling reform of the financial services industry and markets and coordinating reforms with other countries. There can be no assurance that these various initiatives or any other future legislative or regulatory initiatives will be successful at improving economic conditions globally, nationally or in Norwood’s markets, or that the measures adopted will not have adverse consequences.

Recent levels of market volatility are unprecedented.

The capital and credit markets have recently experienced volatility and disruption which reached unprecedented levels. In some cases, the markets produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers’ underlying financial strength. If these levels of market disruption and volatility return, there can be no assurance that Norwood will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

Liquidity risk could impair Norwood’s ability to fund operations and jeopardize its financial condition.

Liquidity is essential to Norwood’s business. An inability to raise funds through deposits, borrowings, the sale of loans and investments and other sources could have a substantial negative effect on its liquidity. Norwood’s access to funding sources in amounts adequate to finance its activities or on terms which are acceptable to it could be impaired by factors that affect it specifically or the financial services industry or economy in general. Factors that could detrimentally impact Norwood’s access to liquidity sources include a decrease in the level of its business activity as a result of a downturn in the markets in which its loans are concentrated or adverse regulatory action against it. Norwood’s ability to borrow could also be impaired by factors that are not specific to it, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations and the deterioration in credit markets.



Norwood may elect or be compelled to seek additional capital in the future, but that capital may not be available when it is needed.

Norwood is required by federal and state regulatory authorities to maintain adequate levels of capital to support its operations. In addition, Norwood may elect to raise additional capital to support its business or to finance acquisitions, or may otherwise elect or be required to raise additional capital. In that regard, a number of financial institutions have recently raised considerable amounts of capital in response to a deterioration in their results of operations and financial condition arising from the turmoil in the mortgage loan market, deteriorating economic conditions, declines in real estate values and other factors. Should Norwood be required by regulatory authorities to raise additional capital, it may seek to do so through the issuance of, among other things, its common stock or preferred stock.

Norwood's ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside its control, and on its financial performance. Accordingly, there can be no assurance of its ability to raise additional capital if needed or on terms acceptable to it. If Norwood is unable to raise additional capital when needed, it may have a material adverse effect on its financial condition, results of operations and prospects.

Norwood's business is geographically concentrated and is subject to regional economic factors that could have an adverse impact on its business.

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

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

The loss of senior executive officers and certain other key personnel could hurt Norwood's business.

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

Norwood's legal lending limits are relatively low and restrict its ability to compete for larger customers.

At September 30, 2010, Norwood's lending limit per borrower was approximately \$10.2 million, or 15% of its capital plus allowance for loan losses. Accordingly, the size of loans that it can offer to potential borrowers is less than the size of loans that many of its competitors with larger capitalization are able to offer. Norwood may engage in loan participations with other banks for loans in excess of its legal lending limits. However, there can be no assurance that such participations will be available at all or on terms which are favorable to it and its customers.

#### Risks Related to Norwood's Common Stock

There is a limited trading market for the Norwood common stock, which may adversely impact your ability to sell your shares and the price you receive for your shares.

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

There are restrictions on Norwood's ability to pay cash dividends.

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

Norwood common stock is not insured and you could lose the value of your entire investment.

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

Norwood's management and significant shareholders control a substantial percentage of its stock and therefore have the ability to exercise substantial control over its affairs.

As of September 30, 2010, Norwood's directors and executive officers beneficially owned approximately 212,000 shares, or approximately 7.3% of its common stock, including options to purchase 140,885 shares, in the aggregate, of the Norwood common stock at exercise prices ranging from \$10.36 to \$31.50 per share. Following the merger, the percentage beneficial ownership, including options, of Norwood's directors and executive officers is expected to be approximately 6.4%. Because of the large percentage of stock held by its directors and executive officers and other significant shareholders, these persons could influence the outcome of any matter submitted to a vote of its shareholders.

We may issue additional shares of common or preferred stock, which may dilute the ownership and voting power of our shareholders and the book value of our common stock.

Norwood is currently authorized to issue up to 10,000,000 shares of common stock of which 2,760,895 shares are currently outstanding and an additional 532,315 shares are estimated to be issued in





the merger, and up to 5,000,000 shares of preferred stock of which no shares are outstanding. The Board of Directors has authority, without action or vote of the shareholders, to issue all or part of the authorized but unissued shares and to establish the terms of any series of preferred stock. These authorized but unissued shares could be issued on terms or in circumstances that could dilute the interests of other shareholders. In addition, a total of 250,000 shares of common stock have been reserved for issuance under the Norwood Financial Corp. 2006 Stock Option Plan, of which 121,700 were issued as of September 30, 2010. As of September 30, 2010, options to purchase a total of 140,885 shares were exercisable and had exercise prices ranging from \$10.36 to \$31.50. Any such issuance will dilute the percentage ownership interest of shareholders and may further dilute the book value of our common stock.

Provisions of Norwood's Articles of Incorporation and the Pennsylvania Business Corporation Law could deter takeovers which are opposed by the Board of Directors.

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

#### Risks Related to Norwood's Industry

Norwood operates in a competitive market which could constrain its future growth and profitability.

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

Norwood is required to comply with extensive and complex governmental regulation which can adversely affect its business.

Norwood's operations are and will be affected by current and future legislation and by the policies established from time to time by various federal and state regulatory authorities. It is subject to supervision and periodic examination by the Federal Reserve Board (the "FRB"), the FDIC and the Pennsylvania Department of Banking. Banking regulations, designed primarily for the safety of depositors, may limit a financial institution's growth and the return to its investors by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, investments, loans and interest rates, interest rates paid on deposits, expansion of branch offices, and the offering of



securities or trust services. Norwood is also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that it is found by regulatory examiners to be undercapitalized. It is not possible to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that any such changes may have on its future business and earnings prospects. Further, the cost of compliance with regulatory requirements may adversely affect Norwood's ability to operate profitably.

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

Norwood realizes income primarily from the difference between interest earned on loans and investments and interest paid on deposits and borrowings, and changes in interest rates may adversely affect its profitability and assets.

Changes in prevailing interest rates may hurt Norwood's business. Norwood derives its income mainly from the difference or "spread" between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. In general, the larger the spread, the more it earns. When market rates of interest change, the interest it receives on its assets and the interest it pays on its liabilities will fluctuate. This can cause decreases in its spread and can adversely affect its income.

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

As a public company, Norwood is subject to numerous reporting requirements that are currently evolving and could substantially increase its operating expenses and divert management's attention from the operation of its business.

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

As directed by Section 404 of the Sarbanes-Oxley Act, the SEC adopted rules requiring public companies to include a report of management on Norwood's internal control over financial reporting in their annual reports on Form 10-K that contains an assessment by management of the effectiveness of

Norwood's internal control over financial reporting. In addition, the independent registered public accounting firm auditing Norwood's financial statements must report on the effectiveness of Norwood's internal control over financial reporting. If Norwood is ever unable to conclude that it has effective internal control over financial reporting or, if its independent auditors are unable to provide it with an unqualified report as to the effectiveness of its internal control over financial reporting for any future year-ends as required by Section 404, investors could lose confidence in the reliability of its financial statements, which could result in a decrease in the value of its securities.

CAUTIONARY STATEMENT REGARDING  
FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. These forward-looking statements include, but are not limited to, (i) the financial condition, results of operations and business of Norwood and North Penn; (ii) statements about the benefits of the merger, including future financial and operating results, cost savings, enhancements to revenue and accretion to reported earnings that may be realized from the merger; (iii) statements about our respective plans, objectives, expectations and intentions and other statements that are not historical facts; and (iv) other statements identified by words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimates,” or words of similar meaning. When used in this document, the words “believes,” “anticipates,” “contemplates,” “expects,” and similar expressions are intended to identify forward-looking statements. These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

In addition to the factors discussed under “Risk Factors,” the following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- Norwood’s and North Penn’s businesses may not be combined successfully, or such combination may take longer to accomplish than expected;
- the growth opportunities and cost savings from the merger may not be fully realized or may take longer to realize than expected;
- operating costs, customer losses and business disruption following the merger, including adverse effects of relationships with employees, may be greater than expected; and
- governmental approvals of the merger may not be obtained, or adverse regulatory conditions may be imposed in connection with governmental approvals of the merger.

Neither Norwood nor North Penn undertakes any obligation to publicly release the results of any revisions to those forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

## MARKET VALUE OF SECURITIES

Norwood. Norwood's common stock is traded on the Nasdaq Global Market under the symbol "NWFL". As of February 7, 2011, there were approximately 1,500 shareholders based on transfer agent mailings.

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

	Closing Price Range		Cash dividends declared per share
	High	Low	
Year 2011			
First Quarter (through February 7, 2011)	\$ 27.96	\$ 26.25	\$ --
Year 2010			
First Quarter	\$ 29.49	\$ 25.22	\$ 0.28
Second Quarter	28.76	23.94	0.28
Third Quarter	29.10	24.42	0.28
Fourth Quarter	29.99	25.75	0.29
Year 2009			
First Quarter	\$ 29.45	\$ 22.95	\$ 0.27
Second Quarter	32.00	24.10	0.27
Third Quarter	33.25	30.57	0.27
Fourth Quarter	31.10	25.50	0.28

North Penn. North Penn's common stock is quoted on the OTC Bulletin Board under the symbol "NPBP.OB". An active trading market does not currently exist for the North Penn common stock. The over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions. As of \_\_\_\_\_, 2011, there were approximately \_\_\_\_ holders of record of North Penn common stock.

The following table shows the high and low bid closing sales prices of the North Penn common stock as reported on the OTC Bulletin Board the periods shown and the quarterly cash dividends declared per share for the periods indicated. Market quotations reflect inter-dealer prices, without retail mark-up, markdown, or commission, and may not necessarily reflect actual transactions.

	Closing Price Range		Cash dividends declared per share
	High	Low	
Year 2011			
First Quarter (through February 7, 2011)	\$ 17.50	\$ 16.90	\$ 0.04
Year 2010			
First Quarter	\$ 10.00	\$ 9.10	\$ 0.09
Second Quarter	11.00	9.35	0.04
Third Quarter	10.95	9.05	0.04
Fourth Quarter	17.50	10.55	0.04
Year 2009			
First Quarter	\$ 8.00	\$ 6.00	\$ 0.03

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Second Quarter	8.80	6.00	0.03
Third Quarter	9.25	8.55	0.03
Fourth Quarter	9.25	8.75	0.03

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## COMPARATIVE PER SHARE DATA

The following table sets forth historical per share information for Norwood and North Penn and additional information as if the companies had been combined for the periods shown, which we refer to as “pro forma” information. The pro forma information is based upon the assumption that the total number of shares of North Penn common stock outstanding immediately prior to the completion of the merger will be 1,336,130 (including unvested shares of restricted stock) and utilizes the exchange ratio of 0.6829. It is further assumed that a total of \$3.32 million is paid in settlement of outstanding stock options and unallocated ESOP shares and that there are no dissenting shareholders. Based on these assumptions, 779,492 of the 1,336,130 shares of North Penn common stock would be exchanged for Norwood common stock, with the balance of the North Penn shares being exchanged for cash.

The North Penn pro forma equivalent per share amounts are calculated by multiplying the Norwood pro forma combined book value per share, cash dividends per share and net income per share by the exchange ratio of 0.6829 so that the per share amounts equate to the respective values for one share of North Penn common stock. The unaudited pro forma Norwood per share equivalents are calculated by combining the Norwood historical share amounts with pro forma amounts from North Penn, assuming the exchange ratio of 0.6829.

We present below for Norwood and North Penn historical, unaudited pro forma combined and pro forma equivalent per share financial data for the year ended December 31, 2009 and the interim period ended September 30, 2010. This data should be read together with the selected historical financial data of Norwood and North Penn and the unaudited pro forma combined condensed financial statements included in this document. This data should also be read together with Norwood’s consolidated financial statements and related notes included under beginning on page F-1 and North Penn’s consolidated financial statements and related notes beginning on page F-50 of this proxy statement/prospectus. The per share data is not necessarily indicative of the operating results that Norwood would have achieved had it completed the merger as of the beginning of the periods presented and should not be considered as representative of future operations.

	Norwood Historical	North Penn Historical	Pro Forma Norwood	Equivalent Pro Forma North Penn(1)
Book value per share				
September 30, 2010	\$ 24.79	\$ 16.01	\$ 25.31	\$ 17.28
December 31, 2009	23.25	14.49	23.66	16.16
Cash dividends declared per share				
Nine months ended September 30, 2010	0.84	0.17	0.84	0.57
Year ended December 31, 2009	1.09	0.12	1.09	0.74
Basic net income per share				
Nine months ended September 30, 2010	1.99	0.63	1.89	1.29
Year ended December 31, 2009	2.57	0.57	2.35	1.60
Diluted net income per share				
Nine months ended September 30, 2010	1.99	0.62	1.87	1.28
Year ended December 31, 2009	2.55	0.57	2.33	1.59

(1) The North Penn equivalent pro forma information shows the effect of the merger from the perspective of an owner of North Penn common stock. We calculated the North Penn equivalent information by multiplying the Norwood and North Penn combined pro forma per share amounts by the exchange ratio of 0.6829 and after giving effect to the pro forma adjustments. The calculations do not reflect for the cash component of the merger consideration.



## THE SPECIAL MEETING OF SHAREHOLDERS

North Penn is mailing this proxy statement/prospectus to you as a North Penn shareholder on or about \_\_\_\_\_, 2011. With this proxy statement/prospectus, North Penn is sending you a notice of the North Penn special meeting of shareholders and a form of proxy that is solicited by the North Penn board of directors. The special meeting will be held on \_\_\_\_\_, 2011 at \_\_\_\_:\_\_\_ .m., Eastern Time, at \_\_\_\_\_, \_\_\_\_\_, Pennsylvania \_\_\_\_\_.

### Matters to be Considered

The purpose of the special meeting of shareholders is to vote on the adoption of the merger agreement, pursuant to which North Penn will be merged with and into Norwood.

You are also being asked to vote upon a proposal to adjourn, postpone or continue the special meeting of shareholders, if necessary, to permit further solicitation of proxies in favor of adopting the merger agreement. North Penn could use any adjournment or postponement for the purpose, among others, of allowing additional time to solicit proxies.

### Who Can Vote at the Meeting

You are entitled to vote the shares of North Penn common stock that you owned as of the close of business on \_\_\_\_\_, 2011. As of the close of business on \_\_\_\_\_, 2011, a total of \_\_\_\_\_ shares of North Penn common stock were outstanding. Each share of common stock has one vote.

North Penn's articles of incorporation provide that record holders of North Penn common stock who beneficially own, either directly or indirectly, in excess of 10% of the outstanding shares of North Penn common stock are not entitled to any vote with respect to the shares held in excess of the 10% limit.

### Ownership of Shares; Attending the Meeting

You may own shares of North Penn in one of the following ways:

- Directly in your name as the shareholder of record;
- Indirectly through a broker, bank or other holder of record in "street name"; or
- Indirectly in the North Penn Bancorp, Inc. Stock Fund of the North Penn Bank Employees' Savings and Profit Sharing Plan and Trust (the "401(k) Plan") or in the North Penn Bank Employee Stock Ownership Plan (the "ESOP").

If your shares are registered directly in your name, you are the holder of record of these shares and we are sending these proxy materials directly to you. As the holder of record, you have the right to give your proxy directly to us or to vote in person at the meeting. If you hold your shares in street name, your broker, bank or other holder of record is sending these proxy materials to you. As the beneficial owner, you have the right to direct your broker, bank or other holder of record how to vote by filling out a voting instruction form that accompanies your proxy materials. Your broker, bank or other holder of record may allow you to provide voting instructions by telephone or by the Internet. Please see the instruction form provided by your broker, bank or other holder of record that accompanies this proxy statement. If you hold your shares in street name, you will need proof of ownership to be admitted to the



meeting. A recent brokerage statement or letter from a bank or broker are examples of proof of ownership. If you want to vote your shares of North Penn common stock held in street name in person at the meeting, you must obtain a written proxy in your name from the broker, bank or other nominee who is the record holder of your shares.

#### Quorum and Vote Required

Quorum. We will have a quorum and will be able to conduct the business of the special meeting if the holders of a majority of the outstanding shares of common stock entitled to vote are present at the meeting, either in person or by proxy.

Votes Required for Proposals. Under Pennsylvania law, approval of at least a majority of the votes cast at the special meeting is required to approve the merger agreement. As of the record date, directors and executive officers of North Penn and their affiliates, had the right to vote approximately \_\_\_\_\_ shares of North Penn common stock, or \_\_\_\_\_% of the outstanding shares of North Penn common stock at that date. Each of the directors and executive officers of North Penn have entered into voting agreements with Norwood to vote all of their shares of North Penn common stock in favor of the merger.

Approval of the proposal to adjourn, postpone or continue the special meeting, if necessary, for the purpose of soliciting additional proxies requires the affirmative vote of the holders of a majority of the votes cast in person or represented by proxy at the special meeting, whether or not a quorum is present.

How We Count Votes. If you return valid proxy instructions or attend the meeting in person, we will count your shares for purposes of determining whether there is a quorum, even if you abstain from voting. Broker non-votes also will be counted for purposes of determining the existence of a quorum.

#### Voting by Proxy

The Board of Directors of North Penn is sending you this proxy statement/prospectus for the purpose of requesting that you allow your shares of North Penn common stock to be represented at the special meeting by the persons named in the enclosed proxy card. All shares of North Penn common stock represented at the annual meeting by properly executed and dated proxy cards will be voted according to the instructions indicated on the proxy card. If you sign, date and return a proxy card without giving voting instructions, your shares will be voted as recommended by North Penn's board of directors. The board of directors recommends a vote "FOR" each of the proposals.

If any matters not described in this proxy statement/prospectus are properly presented at the special meeting, the persons named in the proxy card will use their own best judgment to determine how to vote your shares. If the special meeting is postponed or adjourned, your North Penn common stock may be voted by the persons named in the proxy card on the new special meeting date as well, unless you have revoked your proxy. We do not know of any other matters to be presented at the special meeting.

You may revoke your proxy at any time before the vote is taken at the meeting. To revoke your proxy, you must either advise the Corporate Secretary of North Penn in writing before your shares of North Penn common stock has been voted at the special meeting, deliver a later dated proxy or attend the meeting and vote your shares in person. Attendance at the special meeting will not in itself constitute revocation of your proxy.

### Participants in the ESOP and 401(k) Plan

If you participate in the ESOP or if you hold shares through the 401(k) Plan, you will receive a voting instruction form for each plan that reflects all shares you may direct the trustees to vote on your behalf under the plans. Under the terms of the ESOP, the ESOP trustee votes all shares held by the ESOP, but each ESOP participant may direct the trustee how to vote the shares of common stock allocated to his or her account. The ESOP trustee, subject to the exercise of its fiduciary duties, will vote all unallocated shares of North Penn common stock held by the ESOP and allocated shares for which no voting instructions are received in the same proportion as shares for which it has received timely voting instructions. Under the terms of the 401(k) Plan, a participant is entitled to direct the trustee as to the shares in the North Penn Bancorp, Inc. Stock Fund credited to his or her account. The trustee, subject to its fiduciary duties, will vote all shares for which no directions are given or for which instructions were not timely received in the same proportion as shares for which the trustee received voting instructions. The deadline for returning your voting instructions to each plan's trustee is \_\_\_\_\_, 2011.

### Solicitation of Proxies

The costs and expenses of printing and mailing this proxy statement/prospectus will be borne by Norwood, and North Penn will bear all other costs incurred by it in the solicitation of proxies from its shareholders on behalf of its Board of Directors. In addition to solicitation of proxies by mail, North Penn will request that banks, brokers and other record holders send proxies and proxy materials to the beneficial owners of North Penn common stock and secure their voting instructions. North Penn will reimburse the record holders for their reasonable expenses in taking those actions. North Penn has also made arrangements with Regan & Associates, Inc., a proxy solicitation firm, to assist it in soliciting proxies and has agreed to pay them approximately \$5,000 plus reasonable expenses for these services. North Penn may use its directors, officers and employees, who will not be specially compensated, to solicit proxies from North Penn shareholders, either personally or by telephone, facsimile, letter or other electronic means.

### THE MERGER AND THE MERGER AGREEMENT

The following summary of the merger and merger agreement is qualified by reference to the complete text of the merger agreement. A copy of the merger agreement is annexed hereto as Annex A and is incorporated by reference into this proxy statement/prospectus. You should read the merger agreement completely and carefully as it, rather than this description, is the legal document that governs the merger. Factual disclosures about Norwood and North Penn contained in this proxy statement/prospectus or in the companies' public reports filed with the SEC may supplement, update or modify the factual disclosures about the companies contained in the merger agreement. The representations, warranties and covenants made in the merger agreement by North Penn and Norwood were qualified and subject to important limitations agreed to by the parties in connection with negotiating the terms of the merger agreement. In particular, in your review of the representations and warranties contained in the merger agreement and described in this summary, it is important to bear in mind that the representations and warranties were negotiated with the principal purposes of establishing the circumstances in which a party to the merger agreement may have the right not to close the merger if the representations and warranties of the other party prove to be untrue due to a change in circumstance or otherwise, and allocating risk between the parties to the merger agreement, rather than establishing matters as facts. The representations and warranties may also be subject to a contractual standard of materiality different from those generally applicable to shareholders and reports and documents filed with the SEC and in some cases were qualified by disclosures that were made by each party to the other, which disclosures were not reflected in the merger agreement. Moreover, information concerning the subject matter of the representations and warranties, which do not purport to be accurate as of the date



of this proxy statement/prospectus, may have changed since the date of the merger agreement and subsequent developments or new information qualifying a representation or warranty may have been included in this proxy statement/prospectus.

#### General

The merger agreement provides for the merger of North Penn with and into Norwood, with Norwood as the surviving entity. Immediately following the merger, North Penn Bank will merge with and into Wayne Bank, with Wayne Bank as the surviving entity.

#### Background of the Merger

North Penn's board of directors has regularly reviewed and evaluated strategic options available to us with the goals of strengthening North Penn's capital and financial position, identifying opportunities for growth consistent with safe and sound banking operations, and enhancing long-term shareholder value. This strategic evaluation process led to converting North Penn Bank to the mutual holding company structure and undertaking a public stock offering in 2005 and subsequently conducting a "second step" conversion into the stock holding company structure and undertaking a second public offering in 2007. After completing the second step conversion in October 2007, North Penn was restricted for a period of three years from entering into a business combination in which it was not the surviving entity.

Although North Penn was restricted from engaging in a business combination, from time to time representatives of various area financial institutions (but not including Norwood) expressed their interest to Frederick L. Hickman, North Penn's President and CEO, regarding the possibility of North Penn engaging in a business combination with their institutions once the three year moratorium had expired. No deal terms were ever proposed or discussed in connection with any of these communications, nor did North Penn actively evaluate or pursue any of these expressions of interest.

In late January 2010, Mr. Hickman met with a representative of The Kafafian Group, Inc. ("TKG") a consulting firm with significant experience providing financial advisory services to banks and thrifts, to discuss the current state of the Northeast Pennsylvania banking market, North Penn's prospects as an independent institution, and the mergers and acquisition landscape. TKG was subsequently invited to prepare a formal presentation to North Penn's board of directors regarding these subjects.

At the board of director's regular meeting on March 23, 2010, TKG delivered a presentation to the directors that provided a financial industry overview, market analysis, peer group analysis, and review of the current mergers and acquisitions landscape, including recent transactions. As part of this presentation, TKG presented illustrations of the financial effects of a business combination with several area financial institutions, including those that had previously expressed an interest in North Penn. It was discussed that, although North Penn had performed well during a time when many other banks were struggling, increasing regulatory burdens would soon require North Penn to make major investments in technology and compliance that would increase North Penn's cost structure and negatively impact its profitability. It was the consensus of the directors that growing regulatory burdens would increasingly make it very difficult for a small financial institution to effectively compete while creating long-term value for shareholders and that, when the regulatory limitations on engaging in a business combination expired, North Penn should explore the possibility of combining with a larger institution.

Over the subsequent months, two area financial institutions expressed to Mr. Hickman their interest in a business combination with North Penn. No deal terms were proposed or discussed. Mr. Hickman reported on these discussions to North Penn's board of directors.





On September 7, 2010, representatives of TKG met with Mr. Hickman and Mr. Lamont to update the analysis prepared in March and further discuss the Northeast Pennsylvania banking market and the mergers and acquisition landscape. At that meeting, they discussed the process for soliciting indications of interest to acquire North Penn and determined that North Penn would have a preference for a transaction that offered North Penn shareholders the opportunity to receive either cash or common stock of the acquirer, or some combination thereof.

At a meeting on September 28, 2010, North Penn's board of directors met with representatives of TKG. Also present at the meeting was a representative of Kilpatrick Townsend & Stockton LLP, which we refer to as Kilpatrick Townsend, a law firm with significant experience advising financial institutions. The representative of Kilpatrick Townsend made a presentation regarding the fiduciary duties and responsibilities of North Penn's board of directors in the context of a business combination transaction and discussed the timing, process and regulatory and shareholder approval requirements for a merger transaction.

TKG presented to the directors a draft of a confidential information memorandum that would be distributed to interested parties, which contained non-public information regarding North Penn's business and recent operating performance. TKG discussed the goals of the process, with the primary objective being to obtain the highest per share consideration for North Penn's shareholders, and the terms that interested parties would be asked to address as part of their proposals. In addition to price per share, these included, among other things, the structure of the proposed transaction, treatment of stock options, personnel issues, treatment of North Penn benefit plans, due diligence procedures, and the existence of financing or other contingencies.

TKG presented a list of 18 financial institutions that could potentially be interested in a merger with North Penn and provided some background information on the likelihood of their interest in a business combination with North Penn. The list of potential transaction partners was developed by TKG based on consultation with North Penn's management, analysis of publicly available information about other financial institutions, and their knowledge and expertise concerning North Penn's market area and the current market for transactions involving financial institutions. The proposed list included the two institutions that had expressed an interest in North Penn. The directors discussed whether there were any other reasonably likely potential merger partners who had been omitted from the list and concluded that there were not. It was the consensus of the Board that the list presented by TKG was appropriate and that all of the institutions on the list should be contacted to determine their interest in a potential business combination with North Penn. At this meeting, the board of directors also approved retaining TKG and Kilpatrick Townsend as North Penn's financial advisor and legal advisor, respectively.

In early October 2010, TKG, with the assistance of management of North Penn, finalized the confidential information memorandum and contacted the financial institutions on the list presented to the directors to ascertain their interest in a possible business combination. Twelve of the institutions contacted executed confidentiality agreements and thereafter TKG identified North Penn as the acquisition target and provided the interested parties with a copy of the confidential information memorandum. The interested parties were given until October 29, 2010 to submit a proposal.

By October 29, 2010, five of the institutions, including Norwood and the two institutions that earlier in the year had expressed an interest in North Penn, had submitted a proposal for a possible business combination. Four of the proposals, including the proposal from Norwood Financial, contemplated that North Penn stock would be exchanged for a combination of cash and common stock of the acquirer, and one of the proposals contemplated a stock-for-stock merger. Each proposal was subject

to further due diligence and other customary conditions. One of the proposals was also subject to a financing condition.

North Penn's board of directors met on November 5, 2010. TKG presented information on the current market for mergers and acquisitions, transaction pricing multiples for comparable transactions and a discounted cash flow analysis. TKG then reviewed the process undertaken to that point and discussed the proposals received by North Penn. TKG informed the board of directors that North Penn had received five proposals for a business combination transaction. TKG reviewed the key characteristics of each proposal, including the amount and type of consideration offered. Of the five proposals, Norwood's proposal offered the highest value to shareholders. In addition, TKG reported that a private equity group had expressed interest in a possible transaction, although it had not yet made a formal proposal. Because a transaction with an entity that was not already approved to own a bank or thrift presented greater execution risk, the board of directors determined to focus on a transaction with an existing financial institution, but would not rule out a transaction with the private equity group if it was significantly more favorable to North Penn shareholders.

TKG also reviewed the next steps in transaction process. The board of directors discussed the need for Norwood to conduct a due diligence investigation of North Penn, the possibility that having multiple parties conduct due diligence could result in a breach of confidentiality that could disrupt the sale process, and the unlikelihood that one of the other financial institutions would be willing or able to increase its offer to an amount greater than Norwood's proposal. Based upon these considerations, the board of directors determined to deal exclusively with Norwood, with the understanding that if Norwood substantially modified its proposal following due diligence that it could resume discussions with the next highest bidder. The board of directors then authorized management to commence negotiations of the terms of a merger between North Penn and Norwood. The board of directors discussed the use of a fixed exchange ratio for the stock portion of the merger consideration, as opposed to a floating exchange ratio, and concluded that there was a preference for a floating exchange ratio.

On November 11 and 12, 2010, representatives of Norwood conducted a due diligence investigation of North Penn. The due diligence investigation included, among other things, discussions with North Penn's senior management and review of North Penn's loan portfolio, securities portfolio and other assets, legal documents and obligations.

Over the following days, representatives of TKG and Boenning & Scattergood, Inc., Norwood's financial advisor, discussed the results of Norwood's due diligence investigation. After further discussions regarding North Penn's loan portfolio, capital structure and expenses related to obligations under North Penn's compensation arrangements, Norwood proposed to acquire North Penn in a merger in which the holders of North Penn common stock would receive \$19.12 in either cash or shares of Norwood common stock.

On November 23, 2010, members of management of North Penn, together with representatives of TKG and Kilpatrick Townsend, conducted a due diligence investigation of Norwood. The due diligence investigation included, among other things, discussions with Norwood's senior management and review of Norwood's loan portfolio, securities portfolio and other assets, legal documents and obligations.

On November 30, 2010, North Penn's board of directors held a regular meeting. At that meeting, representatives of TKG and Kilpatrick Townsend updated the directors on the status of the parties' due diligence investigations and discussed Norwood's updated proposal. The board of directors was also informed that the private equity group that had previously expressed an interest in North Penn had proposed a value that was below Norwood's proposal. The board of directors again discussed the use of fixed exchange ratio versus a floating exchange ratio and was informed that Norwood had expressed a



strong preference for a fixed exchange ratio. The board of directors concluded that Norwood's proposal continued to represent the highest value to shareholders.

On December 1, 2010, legal counsel for Norwood provided a form of merger agreement. Over the ensuing two weeks, representatives of North Penn and Norwood management and outside legal advisors and financial advisors worked to finalize the merger agreement and related documents. Among other things, the parties continued to work to finalize provisions of the merger agreement regarding the determination of the exchange ratio, certain covenants of the parties, the conditions to the parties' obligations to complete the transaction, certain employee compensation arrangements, and the contents of North Penn's disclosure schedules. Norwood agreed to fix the exchange ratio at 0.6829, which resulted in a value of \$19.12 based on a value of Norwood Financial common stock equal to \$28.00 per share, which approximated the average trading price of Norwood Financial common stock over recent weeks.

During this period, the North Penn board recommended to Norwood that Mr. Lamont be considered for the Norwood board. Norwood indicated it was agreeable to the recommendation.

North Penn's board of directors met on December 14, 2010. Kilpatrick Townsend presented a summary of the legal terms of the merger agreement that had been negotiated with Norwood and the shareholder and regulatory approvals that would be required to complete the transaction, including the possible timeframe for obtaining such approvals. North Penn's board of directors also considered the Norwood proposal in the light of the constituency provisions of North Penn's articles of incorporation, including the impact a merger would have on North Penn's employees and the communities in which North Penn or its subsidiaries operate or are located, and Norwood's offer to have a member of North Penn's board of directors become a director of Norwood.

TKG then presented an analysis of the financial terms of the Norwood proposal, including the transaction value, form of consideration, and dividend impact for North Penn's shareholders as well as the historical performance of Norwood's stock, potential effects of the proposed merger on Norwood, Norwood's business and financial information, Norwood's asset and deposit mixes and retail profile, Norwood's branch footprint and overlap with North Penn's branches. TKG's presentation included discussion of the matters described under "Opinion of North Penn's Financial Advisor", beginning on Page 45 of this proxy statement/prospectus. TKG noted that Norwood Financial's proposal of \$19.12 per share of North Penn common stock represented a 75% premium over North Penn's stock price as of December 13, 2010. TKG further noted that Norwood's proposal would be accretive to North Penn's dividends per share.

TKG then delivered to North Penn's board of directors its oral opinion, subsequently confirmed in writing, that based upon and subject to the factors and assumptions stated in that opinion, as of such date, the merger consideration to be received in respect of each share of North Penn common stock in the transaction was fair to North Penn's common shareholders from a financial point of view.

Following these discussions, and extensive review and discussion among North Penn's directors, including consideration of the factors described below under "— Reasons for the Merger; Recommendation of North Penn's Board of Directors" and consideration of TKG's presentation, including TKG's analyses of transaction ratios, the trading history of North Penn common stock and Norwood common stock, financial results of comparable companies, selected merger transactions, discounted cash flow valuation on both a combined company and stand-alone basis, and the pro forma impact of the proposed merger, North Penn's board of directors unanimously approved the Norwood Financial merger agreement and the transactions contemplated thereby. See " -- Opinion of North Penn's Financial Advisor", beginning on Page 45 of this proxy statement/prospectus.



Later in the afternoon on December 14, 2010, after Norwood's board of directors approved the transaction, the parties executed the merger agreement. The transaction was announced in the morning on December 15, 2010.

#### Reasons for the Merger and the Recommendation of the North Penn Board of Directors

After careful consideration, North Penn's board of directors determined that the merger is in the best interests of North Penn and its shareholders. North Penn's board of directors therefore unanimously recommends that the North Penn shareholders vote "FOR" the approval of the merger agreement and the merger.

In reaching the determination to approve the merger, North Penn's board of directors consulted with North Penn's senior management, financial advisor and legal advisor, and drew on its knowledge of the business, operations, properties, assets, financial condition, operating results, historical market prices and prospects of North Penn and Norwood, as well as current economic and market conditions. In connection with its review and approval of the merger, and in the course of its deliberations, North Penn's board of directors considered numerous factors that weighed in favor of the merger, including the following:

- **Merger Consideration.** North Penn's board of directors considered the value of the consideration offered by Norwood. The consideration, at the time of their decision, represented an approximate 75% premium over the market price of North Penn's common stock on December 13, 2010. North Penn's board of directors also considered the adequacy of the merger consideration, not only in relation to the market price of North Penn's common stock, but also in relation to the historical, present and anticipated future operating results and financial position of North Penn as an independent entity.

North Penn's board of directors considered the price level of Norwood's common stock in relation to the price level in recent years and in relation to its peers and the possibility that North Penn shareholders who receive Norwood common stock in the merger would have the opportunity to participate in future stock price growth of Norwood.

North Penn's board of directors also considered the risks and uncertainties in evaluating the merger consideration in view of the potential fluctuation of Norwood's common stock price given the fixed exchange ratio, and the period of time between the execution of the merger agreement and the closing.

- **Strategic Alternatives.** North Penn's board of directors carefully considered the strategic alternatives available to North Penn, including pursuing a business combination with a third party and maintaining the status quo. In this context, North Penn's board of directors considered the economic and competitive pressures facing smaller financial institutions, increasing regulatory burdens, and the need to make major investments in technology and compliance. North Penn's board of directors discussed these alternatives in its deliberations and received advice from senior management, TKG as its financial advisor and Kilpatrick Townsend as its special legal counsel. North Penn's board of directors concluded that the execution of North Penn's business plan under the best case scenarios was not likely to create greater present value for North Penn shareholders compared to the value to be paid by Norwood.
- **The Sale Process.** North Penn's board of directors considered the extent and breadth of the sale process conducted by North Penn, with the assistance of TKG and its legal

advisors, in soliciting, evaluating and responding to potential bidders likely to be interested in acquiring North Penn.

- **TKG's Fairness Opinion and Analysis.** North Penn's board of directors considered the opinion, analyses and presentations of TKG described under the heading "— Opinion of North Penn's Financial Advisor." TKG's opinion concluded that the merger consideration offered to North Penn's common shareholders in the merger was fair from a financial point of view to the holders of such stock.
- **Future Prospects.** North Penn's board of directors evaluated the business, operations, financial conditions, earnings, management and future prospects of Norwood and North Penn and believed that a business combination with Norwood would enable North Penn's shareholders to participate in a combined company that would have enhanced future prospects compared to those that North Penn is likely to achieve on a stand-alone basis. In reaching its conclusion, North Penn's board of directors took into consideration, among other things, the following benefits of a merger with Norwood: enhanced revenue, increased market capitalization, a lower cost of capital, stronger capital position, funding capabilities and liquidity position, cost savings through integration and synergies and, as a result, improved capabilities to cope with potential challenges and risks.
- **Likelihood of Prompt Regulatory Approval.** North Penn's board of directors considered the likelihood that Norwood and North Penn would receive the necessary regulatory approvals to complete the transactions contemplated in the merger agreement, including the merger and the bank merger, in a timely fashion.
- **Terms and Conditions of the Merger Agreement Relating to Closing.** North Penn's board of directors believed the terms and conditions of the merger agreement, including the parties' respective representations and warranties, the conditions to closing and termination provisions, provided adequate assurances as to Norwood's obligation and ability to consummate the merger in a timely manner, without any extraordinary conditions.
- **Norwood's Desire to Appoint a North Penn Director to Norwood's Board of Directors.** North Penn's board of directors considered the ability of North Penn shareholders to retain a voice in management oversight by appointing one of North Penn's directors to Norwood's board of directors.
- **Cash and Stock Election.** North Penn's board of directors considered that shareholders of North Penn would have the opportunity to elect to receive cash or common stock of Norwood in exchange for their shares of North Penn common stock, subject to the proration and allocation provisions of the merger agreement.
- **Tax.** North Penn's board of directors expected that the merger will constitute a reorganization under Section 368(a) of the Code and North Penn shareholders generally will not recognize any gain or loss for federal income tax purposes on the exchange of shares of North Penn common stock for shares of Norwood common stock in the merger, except with respect to any cash received instead of fractional shares of Norwood common stock.
- **Impact on Constituencies.** As permitted by North Penn's articles of incorporation, North Penn's board of directors considered the effect of the merger on the employees,



depositors and customers of North Penn and on the communities in which North Penn operates or is located. North Penn's board of directors believed that Norwood and North Penn share a commitment to their customers, employees, shareholders, and the communities both companies serve. North Penn's board of directors considered that the branch networks of the two banks overlapped in only one location, which was expected to help minimize the job loss resulting from the merger, and that as part of a larger organization North Penn's employees would have greater career opportunities. North Penn's board of directors also considered Norwood's ability to provide a wider array of products, including trust services, as well as larger lending limits as being beneficial to North Penn's customers.

In the course of its deliberation regarding the merger, North Penn's board of directors also considered the following factors, which it determined did not outweigh the expected benefits to North Penn and its shareholders:

- **Provisions and Covenants Contained in the Merger Agreement.** North Penn's board of directors considered the restrictions on the operation of North Penn's business during the period between signing of the merger agreement and completion of the merger, as well as other covenants and agreements of North Penn contained in the merger agreement. North Penn's board of directors also considered the provisions of the merger agreement relating to payment of the termination fee upon certain events, and the limitations on North Penn's ability to discuss alternative transactions during the pendency of the merger. North Penn's board of directors further considered the requirement that North Penn must convene a special meeting of common shareholders to vote on the transaction with Norwood regardless of whether it changes its recommendation unless the merger agreement is terminated.
- **Completion Risks.** North Penn's board of directors considered the risks and costs associated with the merger not being completed in a timely manner or at all, including as a result of any failure to obtain requisite regulatory approvals. North Penn's board of directors considered that these risks and costs included the diversion of management and employee attention, potential employee attrition, the potential effect on business and customer relationships and potential litigation brought by shareholders of North Penn arising from the merger agreement or the transactions contemplated thereby.
- **Integration Risks.** North Penn's board of directors considered the challenges of combining the businesses, assets and workforces of North Penn and Norwood, which could affect the post-merger success and the ability to achieve anticipated cost savings and other potential synergies. North Penn's board of directors considered that Norwood had no recent experience in integrating an acquisition.
- **Insider Interests.** North Penn's board of directors considered the fact that the interests of North Penn directors and executive officers with respect to the merger may be different from those of other North Penn shareholders in certain limited circumstances. See "The Merger and the Merger Agreement — Interests of Certain Persons in the Merger" on Page 61.

The reasons set forth above are not intended to be exhaustive, but include the material considerations of North Penn's board of directors in approving the merger agreement. In reaching its determination to approve and recommend the transaction, North Penn's board of directors looked at the totality of the information presented to it and did not assign any relative or specific weights to the factors

considered, and individual directors may have given different weights to different factors. After considering, among other things, the matters discussed above and the opinion of TKG referred to above, North Penn's board of directors believed that the merger was in the best interests of North Penn and its shareholders, and therefore, unanimously approved and recommended the merger.

It should be noted that this explanation of the reasoning of North Penn's board of directors (and some other information presented in this section) is forward-looking in nature and, therefore, should be read in light of the factors discussed under the section of this proxy statement/prospectus entitled "Cautionary Statement Regarding Forward-Looking Statements" commencing on Page 31.

#### Norwood's Reasons for the Merger

In reaching its determination to approve and adopt the merger agreement, the board of directors of Norwood considered a number of factors, including:

- the complementary geographical locations of North Penn's branch network, which will augment Norwood's operations;
- the board's understanding of, and the presentations of Norwood's management and financial advisor regarding, North Penn's business, operations, management, financial condition, asset quality, earnings and prospects;
- the board's view that the merger is consistent with Norwood's expansion strategy and will allow for enhanced opportunities for Norwood's new and existing clients and customers;
- the results of management's due diligence investigation of North Penn and the reputation, business practices and experience of North Penn and its management, including their impression that North Penn is a financially healthy, well run bank holding company that is deeply committed to its customers, employees, and the communities that it serves;
- the fact that the merger is expected to be accretive to earnings per share of Norwood in 2012;
- the anticipated operating efficiencies, cost savings and opportunities for revenue enhancements of the combined company following the completion of the merger, and the likelihood that they would be achieved after the merger;
- the fact that the merger consideration consists of a mixture of cash and stock in which shareholders would have an election, subject to limitations;
- the fact that the per share stock consideration is fixed;
- the deal protection provided by the termination fee of \$1,125,000 payable under certain circumstances in the event of the termination of the Merger Agreement due to a competing offer or certain other reasons;
- the intended tax treatment of the merger as a tax-free reorganization; and
- the likelihood of receiving all of the regulatory approvals required for the merger.



Based on these reasons, Norwood's board of directors unanimously approved the merger agreement and the merger. This discussion of the factors considered by Norwood's board of directors does not list every factor considered by the board but includes all material factors considered by the board. In reaching its determination to approve and adopt the merger agreement, the board did not give relative or specific importance to each of the factors listed above, and individual directors may have given differing importance to different factors. Please note that this explanation of the board's reasoning and all other information presented in this section is forward-looking in nature and, therefore, should be read in light of the factors discussed under the heading "Cautionary Statement Regarding Forward-Looking Statements" beginning on page 31.

#### Opinion of North Penn's Financial Advisor

Pursuant to an engagement letter dated as of October 1, 2010, North Penn engaged TKG to act as its financial advisor in connection with the sale of North Penn based on its qualifications, industry experience, reputation and past assistance to North Penn. TKG, as part of its financial advisory business, is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, and valuations for corporate and other purposes. In the ordinary course of business TKG provides consulting services to financial institutions, including performance measurement, profitability outsourcing, strategic planning, regulatory assistance, profit improvement, and various other financial advisory services. In connection with its engagement, TKG was asked to render an opinion to the North Penn board of directors as to the fairness to North Penn, from a financial point of view, of the merger consideration offered by Norwood.

At the request of North Penn's board of directors, representatives of TKG participated in the special meeting held on December 14, 2010, at which the board of directors considered the proposed merger. At that meeting, representatives of TKG made a presentation to the board of directors of their analyses relating to the proposed transaction and, in particular, of their determination regarding the fairness, from a financial point of view, of the proposed merger consideration to North Penn shareholders. At that meeting, TKG issued its oral opinion, subsequently confirmed in writing, that the consideration to be paid to North Penn by Norwood pursuant to the terms of the merger agreement, dated December 14, 2010, was fair from a financial point of view. Except as discussed herein, no limitations were imposed by North Penn's board of directors upon TKG with respect to investigations made or procedures followed in rendering this opinion.

The full text of TKG's written opinion is attached to this proxy statement/prospectus as Annex B and is incorporated herein by reference. North Penn shareholders are urged to read the opinion in its entirety for a description of the procedures followed, assumptions made, matters considered, and qualifications and limitations of TKG's analyses. TKG's opinion is addressed to the board of directors of North Penn, is directed only to the consideration in the merger and does not constitute a recommendation as to how any holder of North Penn common stock should vote with respect to the merger or any other matter. TKG's opinion speaks only as of the date of the opinion. TKG participated in certain negotiations leading to the merger agreement, but the decision as to whether to enter into the merger agreement was made by North Penn's board of directors.

In rendering its opinion, TKG, among other things:

- Reviewed the Agreement;
- Analyzed regulatory filings and other financial information concerning North Penn;
- Analyzed regulatory filings and other financial information concerning Norwood;
- Discussed past, present, and future financial performance and operating philosophies with North Penn and Norwood senior managements;



- Reviewed certain internal financial data and projections of North Penn and the proposed combined company;
- Reviewed certain internal financial data of Norwood and the proposed combined company;
- Compared the financial condition, financial performance, and market trading multiples of North Penn and Norwood to similar financial institutions;
- Compared the consideration to be paid to North Penn pursuant to the Agreement with the consideration paid in comparable merger transactions of other financial institutions;
- Reviewed the pro forma impact of the merger on the earnings and book value of Norwood and compared the contributions of each institution in a number of key financial categories to the combined company;
- Considered other financial studies, analyses, and investigations and reviewed other information deemed appropriate to render this opinion.

TKG spoke with certain members of senior management and other representatives of North Penn and Norwood to discuss the foregoing as well as matters TKG deemed relevant. As part of its analyses, TKG took into account its assessment of general economic, market and financial conditions, its experience in similar transactions, as well as its experience in and knowledge of the banking industry. TKG's opinion is based upon conditions as they existed and could be evaluated on the respective dates thereof and the information made available to TKG through the respective dates thereof.

TKG has assumed and relied upon the accuracy and completeness of all of the financial and other information reviewed and/or discussed for the purposes of its opinion, without independent investigation. TKG assumed that financial forecasts were deemed reasonable on basis reflecting the best currently available estimates and judgments of senior management and are based on reasonable assumptions, estimates and judgments. Any estimates contained in the analyses performed by TKG are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than suggested by these analyses. Additionally, estimates of the values of businesses or securities do not purport to be appraisals or to reflect the prices at which such businesses or securities might actually be sold.

TKG did not make any independent evaluation or appraisals of either North Penn or Norwood or their respective assets or liabilities, nor was it furnished with any such appraisals. TKG has not made a review of the loans or loan loss reserves or reviewed any individual loan files of North Penn or Norwood. TKG did not conduct a physical inspection of any properties or facilities of North Penn or Norwood. TKG also assumed, without independent verification, that the aggregate allowances for loan losses for North Penn and Norwood were adequate.

On December 14, 2010 TKG rendered a written fairness opinion to North Penn's board of directors. The summary set forth below does not purport to be a complete description of the analyses performed by TKG in connection with the merger. The preparation of a fairness opinion involves various determinations as to the most appropriate and relevant methods of financial analysis and the application of these methods to the particular circumstances. Therefore, the opinion is not readily susceptible to summary description. TKG believes that its analyses must be considered as a whole. Only selecting portions of its analyses and of the factors considered by it could create an incomplete view of the evaluation process underlying the opinion. No one component of the analyses performed by TKG was assigned a greater significance than another component. Taken as a whole, TKG believes these analyses support the conclusion that the consideration to be paid by Norwood to North Penn shareholders is fair, from a financial point of view, to the holders of North Penn common stock.

Proposal Summary – The terms of the merger agreement call for each share of North Penn common stock to be converted into either 0.6829 shares of Norwood common stock or \$19.12 in cash, subject to proration so that 45% of the aggregate consideration is to be paid in cash. The exchange ratio represents a value of \$19.12 per North Penn common share, based on the closing price of Norwood common stock of \$28.00 on December 9, 2010.

Contribution Analysis – TKG reviewed the contribution made by each of Norwood and North Penn to various balance sheet and income statement categories of the combined company based on financial data at or for the quarter ended September 30, 2010. The analysis showed that North Penn would contribute the following percentages of the combined company:

- North Penn shareholders would own 15.4% of the combined company after receiving 55% of the aggregate consideration in Norwood common stock;
- North Penn would contribute 25.3 % of net loans of the combined company;
- North Penn would contribute 23.5 % of total assets of the combined company;
- North Penn would contribute 25.5 % of total deposits of the combined company;
- North Penn would contribute 22.5 % of total stockholders’ equity of the combined company; and
- North Penn would contribute 11.7% of net income of the combined entity.

Discounted Cash Flow Analysis – TKG performed four discounted cash flow analyses. The first and second were “trading” models which valued North Penn as if it remained independent utilizing market price to earnings and price to tangible book values, respectively, to determine terminal values. The third and fourth analyses were “acquisition” models which valued North Penn as if it were to be acquired, utilizing acquisition price to earnings and price to tangible book values, respectively, to determine terminal values. In each analyses, TKG used management projections and estimates, market trading multiples from comparable institutions, specifically price to earnings multiples between 11 and 15 times earnings on a trading basis and 20 and 25 times earnings on an acquisition basis, and price to tangible book multiples between 70% and 90% of tangible book on a trading basis and between 120% and 140% on an acquisition basis, and discount rates of between 8% and 12%. Management estimates of North Penn’s total assets, net income, tangible book value per share, and diluted earnings per share were as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
Total Assets (\$000’s)	180,956	199,051	209,004	215,274	221,732
Net Income (\$000’s)	1,080	1,422	1,755	1,896	1,958
Tangible Book Value Per Share (\$)	15.51	16.36	17.46	18.64	19.87
Diluted Earnings Per Share (\$)	0.78	1.02	1.26	1.36	1.41

TKG calculated a range of net present values of North Penn common stock per share in each scenario. These calculations resulted in a range of implied values of \$7.89 to \$14.37 per share of North Penn common stock, on a trading basis, and \$13.53 to \$23.95, on an acquisition basis, as illustrated by the following tables:

		Price / Earnings Multiple (x)		
Estimated Present Value Per Share	Discount Rate	11.0	13.0	15.0
Trading Basis	8.00%	\$10.54	\$12.45	\$14.37
	10.00%	\$9.61	\$11.36	\$13.11
	12.00%	\$8.78	\$10.38	\$11.98
		20.0	22.5	25.0
Acquisition Basis	8.00%	\$19.16	\$21.55	\$23.95
	10.00%	\$17.48	\$19.66	\$21.85
	12.00%	\$15.97	\$17.97	\$19.96

		Price / Tangible Book Multiple (%)		
Estimated Present Value Per Share	Discount Rate	70.0	80.0	90.0
Trading Basis	8.00%	\$9.47	\$10.82	\$12.17
	10.00%	\$8.64	\$9.87	\$11.10
	12.00%	\$7.89	\$9.02	\$10.15
		120.0	130.0	140.0
Acquisition Basis	8.00%	\$16.23	\$17.58	\$18.93
	10.00%	\$14.80	\$16.04	\$17.27
	12.00%	\$13.53	\$14.66	\$15.78

Although the discounted cash flow analysis is a widely used valuation methodology, it relies on numerous assumptions, including balance sheet and earnings growth rates, discount rates, and market trading multiples that may ultimately be materially different than those used in the analysis. Therefore, this analysis does not purport to be indicative of the actual values or expected values of North Penn common stock.

Peer Group Analysis: Norwood – TKG compared selected balance sheet, asset quality, capitalization, profitability, and market trading ratios to Norwood using financial data for two groups of financial institutions. The data was effective at or for the latest twelve months ended September 30, 2010 and market data on December 10, 2010.

The first group, or “National” peers, compares institutions similar to Norwood. Accordingly, TKG chose 10 publicly traded commercial banks with between \$400 million and \$600 million in total assets, commercial real estate loans to total loans greater than 20%, and a return on average assets greater than 1%.





The second group, or “Regional” peers, compares institutions similar to Norwood. Accordingly, TKG chose 14 publicly traded commercial banks with between \$400 million and \$750 million in total assets located in Pennsylvania, New Jersey, and New York, commercial real estate loans to total loans greater than 20%, non-performing assets to total assets less than 3%, and a return on average assets greater than 0.75%.

Companies included in the Norwood peer groups were:

National Peers	Regional Peers
Baker Boyer Bancorp	1st Summit Bancorp of Johnstown, Inc.
Benchmark Bankshares, Inc.	Allegheny Valley Bancorp, Inc.
Calvin B. Taylor Bankshares, Inc.	CB Financial Services, Inc.
Honat Bancorp, Inc.	CCFNB Bancorp, Inc.
Jeff Davis Bancshares, Inc.	Dimeco, Inc.
Orange County Bancorp, Inc.	Embassy Bancorp, Inc.
Peoples Financial Services Corp.	Evans Bancorp, Inc.
Stonegate Bank	FNB Bancorp, Inc.
Union Bankshares, Inc.	Honat Bancorp, Inc.
Virginia Heritage Bank	Lyons Bancorp, Inc.
	Orange County Bancorp, Inc.
	Penns Woods Bancorp, Inc.
	Peoples Financial Services Corp.
	Somerset Trust Holding Company

(financial data at or for the latest twelve months ended September 30, 2010)	Norwood	National Peers (Median)	Regional Peers (Median)
Loans/Deposits (%)	89.89	84.31	77.26
Tangible Equity/Assets (%)	12.80	10.48	8.82
NPAs/Assets (%)	2.04	1.24	1.14
Reserves/NPAs (%)	50.58	61.88	72.67
Net Interest Margin (%)	4.02	4.17	3.95
Non-interest Income/Total Income (%)	16.05	19.39	20.40
Non-interest Expense/Avg. Assets (%)	2.48	3.00	2.67
Efficiency Ratio (%)	52.72	59.04	61.29
Return on Avg. Assets (%)	1.38	1.29	0.96
Return on Avg. Equity (%)	11.13	11.53	11.36
Price to Earnings (x)	10.3	13.1	11.1
Price to Book Value (%)	113.0	118.4	112.9
Price to Tangible Book Value (%)	113.0	118.4	117.8
Current Dividend Yield (%)	3.96	3.28	3.45

Peer Group Analysis: North Penn – TKG compared selected balance sheet, asset quality, capitalization, profitability, and market trading ratios to North Penn using financial data for two groups of financial institutions. The data was effective at or for the latest twelve months ended September 30, 2010 and market data on December 10, 2010.



The first group, or “National” peers, compares institutions similar to North Penn. Accordingly, TKG chose 15 publicly traded thrifts with less than \$300 million in total assets, non-performing assets to total assets less than 3.25%, and a return on average equity greater than 5%.

The second group, or “Regional” peers, compares institutions similar to North Penn. Accordingly, TKG chose 10 publicly traded thrifts with less than \$500 million in total assets located in the Mid-Atlantic region, commercial and non-performing assets to total assets less than 3%.

Companies included in the North Penn peer groups were:

National Peers	Regional Peers
ASB Financial Corp.	CMS Bancorp, Inc.
BankAffiliated, Inc.	Fairmount Bancorp, Inc.
Century Next Financial Corporation	FedFirst Financial Corporation
Fairmount Bancorp, Inc.	Madison Bancorp, Inc.
FFD Financial Corporation	OBA Financial Services, Inc.
FFB Financial Corp.	Patriot Federal Bank
Great American Bancorp, Inc.	Roebing Financial Corp., Inc.
Home Loan Financial Corporation	Standard Financial Corp.
Logansport Financial Corp.	United-American Savings Bank
Mayflower Bancorp, Inc.	WVS Financial Corp.
Osage Bancshares, Inc.	
Patriot Federal Bank	
Redwood Financial Inc.	
United-American Savings Bank	
Washington Federal Bank for Savings	

(financial data at or for the latest twelve months ended September 30, 2010)	North Penn	National Peers (Median)	Regional Peers (Median)
Loans/Deposits (%)	88.88	88.26	91.38
Tangible Equity/Assets (%)	12.10	9.49	9.14
NPAs/Assets (%)	1.36	0.86	0.93
Reserves/NPAs (%)	74.29	57.09	42.33
Net Interest Margin (%)	3.61	4.08	3.31
Non-interest Income/Total Income (%)	8.95	13.06	7.97
Non-interest Expense/Avg. Assets (%)	2.64	2.71	2.62
Efficiency Ratio (%)	70.20	63.19	80.42
Return on Avg. Assets (%)	0.79	0.76	0.19
Return on Avg. Equity (%)	6.41	8.68	1.69
Price to Earnings (x)	16.6	9.0	27.5
Price to Book Value (%)	80.2	80.2	69.9
Price to Tangible Book Value (%)	80.2	80.2	69.9
Current Dividend Yield (%)	1.6	1.7	0.0

Comparable Transaction Analysis – TKG reviewed the pricing of two comparable groups of merger and acquisition transactions. Group 1 were nationwide transactions announced after January 1, 2008 where the target institution had

total assets between \$100 million and \$2 billion, and non-performing assets to total assets were less than 3%. The criteria resulted in a list of 11 merger and

acquisition transactions (the “National Transactions”). Group 2 were transactions announced after November 1, 2009 where the target institution was a bank or thrift in the Mid-Atlantic region with non-performing assets to total assets less than 4%. The criteria resulted in a list of 10 merger and acquisition transactions (the “Regional Transactions”). For purposes of this analysis, TKG assumed the vesting of unvested North Penn common stock grants. TKG calculated the premium as a percent of core deposits as the amount paid over tangible book value, or the premium, divided by the target’s core deposits, or all deposits less time deposits greater than \$100,000. Transaction multiples are calculated at the time the transactions were announced.

	Norwood – North Penn	National Transactions	Regional Transactions
Price to Book Value (%)	136.12	117.88	119.14
Price to Tangible Book Value (%)	136.12	131.09	123.44
Price to Latest Twelve Months EPS (x)	21.77	23.75	19.31
Price to Deposits (%)	19.84	18.89	13.43
Franchise Premium to Core Deposits (%)	6.10	5.79	3.54

No company or transaction in the preceding Peer Groups and Comparable Transaction analyses is identical to North Penn, Norwood, or the contemplated transaction. Accordingly, an analysis of the results of the foregoing is not mathematically precise; rather, it involves complex considerations and judgments concerning differences in financial and operating characteristics of the companies and other factors that could affect the public trading value of the companies to which they are being compared. The ranges of valuation resulting from any particular analysis described above should not be taken to be TKG’s view of the actual value of North Penn or Norwood.

Compensation of TKG and Other Relationships – North Penn paid TKG a retainer fee of \$20,000 at the signing of the engagement letter between North Penn and TKG on October 1, 2010. North Penn paid TKG a fee of \$30,000 upon the rendering of its fairness opinion. North Penn will pay a transaction fee of 1% of the total consideration paid to North Penn shareholders by Norwood at the consummation of the contemplated transaction. TKG also will be reimbursed for reasonable out of pocket expenses incurred in connection with its engagement and North Penn has agreed to indemnify TKG against certain liabilities. During the two years preceding the date of its opinion, TKG performed profitability outsourcing services for Norwood, for which it also received fees of \$58,000.

#### Consideration to be Received in the Merger

Norwood will pay cash for a number of shares equal to approximately 45% of the North Penn common stock outstanding immediately prior to the effective time of the merger and will issue shares of Norwood common stock for the remaining 55% of such shares. Under the terms of the merger agreement, North Penn shareholders (other than dissenting shareholders) will be given the opportunity to elect for each outstanding share of North Penn common stock they own to receive either:

- \$19.12 in cash, without interest, which we refer to as “cash consideration”;
- 0.6829 of a share of Norwood common stock, which we refer to as “stock consideration”; or
- with respect to certain North Penn shares owned by such shareholder, the cash consideration, and with respect to all other North Penn shares so owned, the stock consideration,



in each case, subject to adjustment, election and allocation procedures specified in the merger agreement.

No fractional shares of Norwood common stock will be issued in connection with the merger. Instead, Norwood will make a cash payment to each North Penn shareholder who would otherwise receive a fractional share.

The per share cash consideration of \$19.12 is fixed. The 0.6829 exchange ratio for the stock consideration is fixed, subject to certain customary anti-dilution adjustments and a potential adjustment at Norwood's option in certain circumstances involving a decline in Norwood's stock price as described under "Terminating the Merger Agreement" beginning on page 72. The per share value of the stock consideration, based upon Norwood's closing stock price on \_\_\_\_\_, 2011, the most recent practicable trading day before this proxy statement/prospectus was finalized, was \$\_\_\_\_\_ per share. The market value of the stock consideration will fluctuate with the price of Norwood common stock. At the time of completion of the merger, the market value of the stock consideration could be greater or less than the value of the cash consideration due to fluctuations in the market price of Norwood common stock.

Under the terms of the merger agreement, the aggregate consideration payable to North Penn shareholders in the merger as of December 14, 2010 (based on an assumed price of \$28.00 per share of Norwood common stock) was allocated approximately 45% in cash and 55% in Norwood common stock. The amount cash to be paid in the merger is \$12,194,000. Amounts paid in settlement of outstanding stock options, for unallocated shares held by the ESOP and for any dissenting shares count towards this amount. Based on the number of outstanding options and unallocated shares held by the ESOP as of the record date and assuming there are no dissenting shares, the remaining cash available to pay shareholders who elect the cash consideration is approximately \$\_\_\_\_\_. We call this number the cash consideration pool.

The stock consideration pool is \_\_\_\_\_ shares of Norwood common stock, subject to certain adjustments specified in the merger agreement.

The allocation procedures in the merger agreement are intended to provide for an approximate 55% stock and 45% cash allocation among all outstanding North Penn shares and options. Norwood common stock will be issued to North Penn shareholders who make cash elections if the cash consideration pool is oversubscribed, so that total aggregate cash consideration payable to North Penn shareholders in the merger shall not exceed the cash consideration pool, and cash will be paid to North Penn shareholders who make stock elections if the cash consideration pool is undersubscribed, so that total aggregate cash consideration payable to North Penn shareholders in the merger equals \$12,194,000. See "-- Allocation Procedures" below. The allocation of the mix of consideration payable to North Penn shareholders in the merger will not be known until Norwood tallies the results of the cash/stock elections made by North Penn shareholders, which will not occur until near or after the closing of the merger.

No guarantee can be made that North Penn shareholders will receive the amounts of cash or stock they elect. As a result of the allocation procedures and other limitations outlined in this proxy statement/prospectus and in the merger agreement, North Penn shareholders may receive Norwood common stock or cash in amounts that vary from the amounts they elect to receive.

North Penn is not making any recommendation as to whether North Penn shareholders should elect to receive cash, Norwood common stock or cash for some shares and stock for the remainder in the merger.



Each North Penn shareholder must make his or her own decision with respect to such election.

#### Election Procedures; Surrender of Stock Certificates

An election form and other customary transmittal materials, with instructions for their completion, is being mailed separately to all holders of record of North Penn common stock as of the record date for the special meeting. The election form and transmittal materials will allow record holders to elect to receive cash, Norwood common stock, or cash for some shares and Norwood common stock for the remainder, or make no election with respect to the merger consideration such shareholders wish to receive. We refer to the shares with respect to which a valid cash consideration election is made as “cash election shares,” the shares with respect to which a valid stock consideration election is made as “stock election shares,” and the shares with respect to which no election is made as “non-election shares.”

To make an effective election, a record shareholder must submit a properly completed election form and transmittal materials along with stock certificates for which an election is made to the exchange agent by the election deadline, which shall be on or before 5:00 p.m., New York time, on the date specified in the election form. An election is properly made only if the exchange agent actually receives a properly completed election form by the election deadline. An election form shall be deemed properly completed only if accompanied by one or more stock certificates (or customary affidavits and indemnification regarding the loss or destruction of such certificates or the guaranteed delivery of such certificates) representing all shares of North Penn common stock covered by such election form, together with duly executed transmittal materials included with the election form.

If you own shares of North Penn common stock in “street name” through a broker or other financial institution, you should receive or seek instructions from the institution holding your shares concerning how to make your election. Any instructions must be given to your broker or other financial institution sufficiently in advance of the election deadline for record holders in order to allow your broker or other financial institution sufficient time to cause the record holder of your shares to make an election as described above. Norwood and/or North Penn will publicly announce the deadline for the receipt of election forms from record holders. “Street name” holders may be subject to an election deadline earlier than the deadline applicable to holders of shares in registered form. Therefore, you should carefully read any materials you receive from your broker. If you instruct a broker to submit an election for your shares, you must follow such broker’s directions for revoking or changing those instructions.

If a North Penn shareholder either (i) does not submit a properly completed election form on or before the election deadline or (ii) revokes its election form prior to the election deadline (without later submitting a properly completed election form prior to the election deadline), the shares of North Penn common stock held by such shareholder shall be designated as non-election shares and will be converted into the right to receive the stock consideration or the cash consideration according to the allocation procedures specified in the merger agreement and summarized below. Any election form may be revoked or changed by the person submitting such election form to the exchange agent by written notice to the exchange agent only if such notice of revocation or change is actually received by the exchange agent at or prior to the election deadline. Stock certificates relating to any revoked election form will be promptly returned without charge. The exchange agent will have discretion to determine when any election, modification or revocation is received and whether any such election, modification or revocation has been properly made. All elections (whether cash, stock or mixed) will be revoked automatically if the merger agreement is terminated. North Penn shareholders are urged to carefully read and follow the instructions for completion of the election form and to submit the form along with the stock certificate(s) in advance of the election deadline.



## Allocation Procedures

The aggregate amount of cash and Norwood common stock that will be paid is subject to the allocation procedures described in detail below. Pursuant to such allocation procedures, if the number of cash election shares multiplied by the cash consideration (together with amounts paid in settlement of stock options, for unallocated ESOP shares and any dissenting shares) would exceed \$12,194,000, a pro rata portion of those shares will be converted into the right to receive Norwood common stock in order to provide for an aggregate cash/stock allocation among all outstanding North Penn shares. Similarly, if the number of cash election shares multiplied by the cash consideration (together with amounts paid in settlement of options, unallocated ESOP shares and dissenting shares) is less than \$12,194,000, all or a pro rata portion of the non-election shares and, if necessary, a pro rata portion of the stock election shares will be converted into the right to receive the cash consideration.

If the number of cash election shares times the cash consideration is less than \$12,194,000, then:

- All cash election shares will be converted into the right to receive the cash consideration.
- Non-election shares will be deemed to be cash election shares to the extent necessary to have the total number of cash election shares times the cash consideration equal \$12,194,000. If less than all of the non-election shares need to be treated as cash election shares, the exchange agent will select the non-election shares to be treated as cash election shares and the remaining non-election shares will be treated as stock election shares.
- If all of the non-election shares are treated as cash election shares and the total number of cash election shares times the cash consideration is still less than \$12,194,000, a pro rata portion of each shareholder's stock election shares will be converted into cash election shares so that the total number of cash election shares times the cash consideration equals \$12,194,000 and the remaining stock election shares will be converted into the right to receive the stock consideration.

If the number of cash election shares times the cash consideration is greater than \$12,194,000, then:

- All stock election shares and all non-election shares will be converted into the right to receive the stock consideration.
- A pro rata portion of each shareholder's cash election shares will be converted into stock election shares so that the remaining number of cash election shares times the cash consideration equals \$12,194,000, the converted stock election shares will be converted into the right to receive the stock consideration, and the remaining cash election shares will be converted in the right to receive the cash consideration shares.

If the number of cash election shares times the cash consideration equals \$12,194,000, then all cash election shares will be converted into the right to receive the cash consideration and all stock election shares and non-election shares will be converted into the right to the stock consideration.

## Exchange Procedures

An election form and transmittal materials will be mailed under separate cover to North Penn shareholders who hold shares of North Penn common stock in registered form. If you wish to make an

election with respect to any of your shares, you must submit an election form and transmittal materials and the certificates which represent your election shares to the exchange agent prior to the election deadline. Do not submit your stock certificates with your proxy card. You should only submit your stock certificates which represent your election shares when you have received and properly completed the election form and transmittal materials. See "-- Election Procedures; Surrender of Stock Certificates" beginning on page 53 of this proxy statement/prospectus.

**Exchange Agent.** At the effective time of the merger, Norwood will deposit with the exchange agent (1) cash in an amount sufficient to allow the exchange agent to make cash consideration payments under the terms of the merger agreement and (2) certificates (or evidence of shares in book entry form) representing shares of Norwood common stock, which we refer to as the "new certificates," each to be given to the holders of North Penn common stock in exchange for old certificates representing shares of North Penn common stock. Any such cash or new certificates remaining in the possession of the exchange agent six months after the effective time will be delivered to Norwood. Any holder of old certificates who has not exchanged his, her or its old certificates by that time will be entitled to look exclusively to Norwood, and only as a general creditor, for the consideration to which he, she or it may be entitled upon exchange of such old certificates.

**Exchange Procedures.** As promptly as practicable after the effective time of the merger, the exchange agent will mail a form of letter of transmittal to each person who was, immediately prior to the effective time, a holder of record of North Penn common stock and who has either (i) not submitted their properly completed election form on or before the election deadline or (ii) revoked their election form prior to the election deadline (without later submitting a properly completed election form prior to the election deadline). The letter of transmittal will contain instructions for use in effecting the surrender of old certificates (to the extent such old certificates have not been surrendered together with the election forms) in exchange for the consideration to which such person may be entitled pursuant to the merger agreement, and will specify that delivery shall be effected, and risk of loss and title to the old certificates shall pass, only upon proper delivery of such certificates to the exchange agent. As soon as practicable after due surrender to the exchange agent of an old certificate for cancellation (to the extent such old certificates have not been surrendered together with the election forms) together with such letter of transmittal duly executed and completed, the holder of such old certificate will be provided a new certificate and a check in the amount to which such holder is entitled pursuant to the merger agreement, and the old certificate shall be canceled. Any amounts required to be deducted and withheld under state, local or foreign tax law will be deducted and withheld from the consideration otherwise payable under the merger agreement.

Until you surrender your North Penn stock certificates for exchange, you will accrue, but will not be paid, any dividends or other distributions declared after the effective time of the merger with respect to Norwood common stock into which any of your shares may have been converted. When you surrender your North Penn stock certificates, to the extent you receive shares of Norwood common stock in exchange, Norwood will pay any unpaid dividends or other distributions, without interest. After the completion of the merger, there will be no transfers on the stock transfer books of North Penn of any shares of North Penn common stock.

If a certificate for North Penn common stock has been lost, stolen or destroyed, the exchange agent will issue the consideration properly payable under the merger agreement upon receipt of appropriate evidence as to that loss, theft or destruction, appropriate evidence as to the ownership of that certificate by the claimant, and appropriate and customary indemnification. The posting of a bond in a reasonable amount may also be required.

## North Penn Stock Options

As of and immediately prior to the effective time of the merger, each outstanding stock option granted by North Penn under North Penn's equity incentive plans as of the effective time will be canceled in exchange for a cash payment equal to the positive difference between \$19.12 and the exercise price of such stock option, multiplied by the number of shares that may be purchased pursuant to such stock option.

## Accounting Treatment

Norwood will account for the merger under the acquisition method of accounting in accordance with U.S. generally accepted accounting principles. Using the acquisition method of accounting, the assets and liabilities of North Penn will be recorded by Norwood at their respective fair values at the time of the completion of the merger. The excess of Norwood's purchase price over the net fair value of the assets acquired and liabilities assumed will then be allocated to identified intangible assets, with any remaining unallocated cost recorded as goodwill. The value of the shares exchanged will be valued at the acquisition date and all merger related costs will be expensed when incurred.

## Tax Consequences of the Merger

This section describes the anticipated material United States federal income tax consequences of the merger to U.S. holders of North Penn common stock who exchange shares of North Penn common stock for shares of Norwood common stock, cash, or a combination of shares of Norwood common stock and cash pursuant to the merger.

For purposes of this discussion, a U.S. holder is a beneficial owner of North Penn common stock who for United States federal income tax purposes is:

- a citizen or resident of the United States;
- a corporation, or an entity treated as a corporation, created or organized in or under the laws of the United States or any state or political subdivision thereof;
- a trust that (1) is subject to (A) the primary supervision of a court within the United States and (B) the authority of one or more United States persons to control all substantial decisions of the trust or (2) has a valid election in effect under applicable Treasury Regulations to be treated as a United States person; or
- an estate that is subject to United States federal income tax on its income regardless of its source.

If a partnership (including for this purpose, any entity treated as a partnership for United States federal income tax purposes) holds North Penn common stock, the tax treatment of a partner generally will depend on the status of the partner and the activities of the partnership. If you are a partner of a partnership holding North Penn common stock, you should consult your tax advisor.

This discussion addresses only those North Penn shareholders that hold their North Penn common stock as a capital asset within the meaning of Section 1221 of the Internal Revenue Code, and does not address all the United States federal income tax consequences that may be relevant to particular North Penn shareholders in light of their individual circumstances or to North Penn shareholders that are subject to special rules, such as:

- financial institutions;
- investors in pass-through entities;
- insurance companies;
- tax-exempt organizations;
- dealers in securities;
- traders in securities that elect to use a mark to market method of accounting;
- persons who exercise dissenters' rights;
- persons that hold North Penn common stock as part of a straddle, hedge, constructive sale or conversion transaction;
- certain expatriates or persons that have a functional currency other than the U.S. dollar;
- persons who are not U.S. holders; and
- shareholders who acquired their shares of North Penn common stock through the exercise of an employee stock option or otherwise as compensation or through a tax-qualified retirement plan.

In addition, the discussion does not address any alternative minimum tax or any state, local or foreign tax consequences of the merger.

The following discussion is based on the Internal Revenue Code, its legislative history, existing and proposed regulations thereunder and published rulings and decisions, all as currently in effect as of the date hereof, and all of which are subject to change, possibly with retroactive effect. Any such change could affect the continuing validity of this discussion.

Norwood and North Penn have structured the merger to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code. The obligation of Norwood to complete the merger is conditioned upon the receipt of an opinion from Malizia Spidi & Fisch, PC, counsel to Norwood, to the effect that the merger will for federal income tax purposes qualify as a reorganization based upon customary representations made by Norwood and North Penn. The obligation of North Penn to complete the merger is conditioned upon the receipt of an opinion from Kilpatrick Townsend & Stockton LLP, counsel to North Penn, to the effect that the merger will for federal income tax purposes qualify as a reorganization based upon customary representations made by Norwood and North Penn. Neither of these opinions is binding on the Internal Revenue Service or the courts. Norwood and North Penn have not requested and do not intend to request any ruling from the Internal Revenue Service as to the United States federal income tax consequences of the merger. Accordingly, each shareholder of North Penn common stock should consult its tax advisor with respect to the particular tax consequences of the merger to such holder. In addition, because a North Penn shareholder may receive a mix of cash and stock despite having made a cash election or stock election, it will not be possible for holders of North Penn common stock to determine the specific tax consequences of the merger to them at the time of making the election.



Tax Consequences of the Merger Generally to Holders of North Penn Common Stock. If the merger is treated as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code, the tax consequences are as follows:

- gain or loss will be recognized by those holders receiving solely cash for North Penn common stock pursuant to the merger equal to the difference between the amount of cash received by a holder of North Penn common stock and such holder's cost basis in such holder's shares of North Penn common stock;
- no gain or loss will be recognized by those holders receiving solely shares of Norwood common stock in exchange for shares of North Penn common stock pursuant to the merger (except with respect to any cash received instead of fractional share interests in Norwood common stock, as discussed in the section entitled "Cash Received Instead of a Fractional Share of Norwood Common Stock" beginning on page 59);
- gain (but not loss) will be recognized by those holders who receive shares of Norwood common stock and cash in exchange for shares of North Penn common stock pursuant to the merger, in an amount equal to the lesser of (1) the amount by which the sum of the fair market value of the Norwood common stock and cash received by a holder of North Penn common stock exceeds such holder's cost basis in its North Penn common stock, and (2) the amount of cash received by such holder of North Penn common stock (except with respect to any cash received instead of fractional share interests in Norwood common stock, as discussed in the section entitled "Cash Received Instead of a Fractional Share of Norwood Common Stock" beginning on page 59);
- the aggregate basis of the Norwood common stock received in the merger will be the same as the aggregate basis of the North Penn common stock for which it is exchanged, decreased by the amount of cash received in the merger (except with respect to any cash received instead of fractional share interests in Norwood common stock), decreased by any basis attributable to fractional share interests in Norwood common stock for which cash is received, and increased by the amount of gain recognized on the exchange (regardless of whether such gain is classified as capital gain, or as ordinary dividend income, as discussed in the section entitled "Recharacterization as a Dividend" beginning on page 59, but excluding any gain or loss recognized with respect to fractional share interests in Norwood common stock for which cash is received); and
- the holding period of Norwood common stock received in exchange for shares of North Penn common stock will include the holding period of the North Penn common stock for which it is exchanged.

If holders of North Penn common stock acquired different blocks of North Penn common stock at different times or at different prices, any gain or loss will be determined separately with respect to each block of North Penn common stock and such holders' basis and holding period in their shares of Norwood common stock may be determined with reference to each block of North Penn common stock. Any such holders should consult their tax advisors regarding the manner in which cash and Norwood common stock received in the exchange should be allocated among different blocks of North Penn common stock and with respect to identifying the bases or holding periods of the particular shares of Norwood common stock received in the merger.

Taxation of Capital Gain. Except as described in the section entitled "Recharacterization as a Dividend" below, gain that holders of North Penn common stock recognize in connection with the merger



generally will constitute capital gain and will constitute long-term capital gain if such holders have held (or are treated as having held) their North Penn common stock for more than one year as of the date of the merger. Long-term capital gain of non-corporate holders of North Penn common stock is generally taxed at preferential rates.

**Recharacterization as a Dividend.** All or part of the gain that a particular holder of North Penn common stock recognizes (or all or part of the cash received by a holder of North Penn common stock, if such holder receives only cash pursuant to the merger) could be treated as dividend income rather than capital gain if (1) such holder is a significant shareholder of Norwood or (2) such holder's percentage ownership, taking into account constructive ownership rules, in Norwood after the merger is not meaningfully reduced from what its percentage ownership would have been if it had received solely shares of Norwood stock rather than cash or a combination of cash and shares of Norwood stock in the merger. This recharacterization as dividend income could happen, for example, because of ownership of additional shares of Norwood stock by such holder of North Penn common stock, ownership of shares of Norwood stock by a person related to such holder or a share repurchase by Norwood from other holders of Norwood stock. The Internal Revenue Service has indicated in rulings that any reduction in the interest of a minority shareholder that owns a small number of shares in a publicly and widely held corporation and that exercises no control over corporate affairs would not result in dividend treatment. Under the constructive ownership rules, a shareholder may be deemed to own stock that is owned by others, such as a family member, trust, corporation or other entity. For an individual who receives dividend income in taxable years beginning before January 1, 2013 that constitutes qualified dividend income, the dividend income may be subject to reduced rates of taxation if such individual meets certain holding period requirements. Because the possibility of dividend treatment depends primarily upon each holder's particular circumstances, including the application of the constructive ownership rules, holders of North Penn common stock should consult their tax advisors regarding the application of the foregoing rules to their particular circumstances.

**Cash Received Instead of a Fractional Share of Norwood Common Stock.** A holder of North Penn common stock who receives cash instead of a fractional share of Norwood common stock will generally be treated as having received the fractional share pursuant to the merger and then as having exchanged the fractional share for cash in a redemption by Norwood. As a result, a holder of North Penn common stock will generally recognize gain or loss equal to the difference between the amount of cash received and the basis in his or her fractional share interest as set forth above. Except as described in the section entitled "Recharacterization as a Dividend" above, this gain or loss will generally be capital gain or loss, and will be long-term capital gain or loss if, as of the effective date of the merger, the holding period for such shares is greater than one year. The deductibility of capital losses is subject to limitations.

**Backup Withholding and Information Reporting.** Payments of cash to a holder of North Penn common stock may, under certain circumstances, be subject to information reporting and backup withholding, unless the holder provides proof of an applicable exemption satisfactory to Norwood and the exchange agent or furnishes its taxpayer identification number, and otherwise complies with all applicable requirements of the backup withholding rules. Any amounts withheld from payments to a holder under the backup withholding rules are not additional tax and will be allowed as a refund or credit against the holder's United States federal income tax liability, provided the required information is furnished to the Internal Revenue Service.

The preceding discussion is intended only as a summary of material United States federal income tax consequences of the merger. It is not a complete analysis or discussion of all potential tax effects that may be important to you. Thus, you are strongly encouraged to consult your tax advisor as to the specific tax consequences resulting from the merger, including tax return

reporting requirements, the applicability and effect of federal, state, local, and other tax laws and the effect of any proposed changes in the tax laws.

#### Regulatory Matters Relating to the Merger

Consummation of the merger and the bank merger are subject to receipt of certain regulatory approvals.

FDIC. Norwood intends to acquire North Penn by way of a merger, whereby North Penn will merge with and into Norwood, with Norwood as the surviving company, and by merging North Penn Bank with Wayne Bank. The merger of North Penn Bank with and into Wayne Bank is subject to the prior approval of the FDIC under the Bank Merger Act. Wayne Bank and North Penn Bank have filed an application with the FDIC to obtain prior approval of the merger of North Penn Bank with and into Wayne Bank. In reviewing applications, the FDIC considers:

- the effect of the transaction upon competition;
- the financial and managerial resources and future prospects of the merging and resulting institutions;
- the capital levels of the surviving savings institution;
- the performance of the applicants in helping to meet the credit needs of the relevant communities, including low- and moderate-income neighborhoods; and
- the convenience and needs of the community to be served.

The FDIC will not approve a transaction:

- that would result in a monopoly or would be in furtherance of any combination, conspiracy or attempt to monopolize the business of banking in any part of the United States; or
- whose effect in any section of the United States may be to substantially lessen competition, or tend to create a monopoly, or which in any other manner would be in restraint of trade, unless the probable effects of the transaction in meeting the convenience and needs of the community clearly outweigh the anti-competitive effects of the transaction.

Any transaction approved by the FDIC may not be completed until 30 days after the FDIC approval, during which time the U.S. Department of Justice may challenge such transaction on antitrust grounds. With the approval of the FDIC and the U.S. Department of Justice, the waiting period may be reduced to 15 days.

Federal Reserve Bank of Philadelphia. Norwood is a bank holding company whose primary federal regulator is the Federal Reserve. Because the merger involves an acquisition by a bank holding company, the transaction is also subject to the non-objection of the Federal Reserve Bank of Philadelphia.

Pennsylvania Department of Banking. The merger of North Penn Bank with and into Wayne Bank is also subject to the prior approval of the Pennsylvania Department of Banking under the

Pennsylvania Banking Code of 1965. Wayne Bank has filed an application for approval of the bank merger with the Department and the application is currently pending. In determining whether to approve the application for the merger of North Penn Bank with and into Wayne Bank, the Department will consider, among other factors, whether the bank merger would be consistent with adequate or sound banking and would not result in concentration of assets beyond limits consistent with effective competition. The Department will also consider the public interest and the needs and convenience of the area primarily to be served by Wayne Bank after the bank merger. Further, it is the policy of the Department to ensure the safe and sound conduct of banking organizations and to maintain public confidence in the business of banking and protect the public interest and the interests of depositors, creditors, and stockholders. These factors will be considered by the Department in connection with Wayne Bank's application.

Status of Applications and Notices. Norwood and North Penn have filed all required applications with applicable regulatory authorities in connection with the merger of North Penn with Norwood's wholly-owned subsidiary and the bank merger. There can be no assurance that all requisite approvals will be obtained, that such approvals will be received on a timely basis or that such approvals will not impose any term, condition or restriction which either party reasonably determines in good faith would materially or adversely affect the economic or business benefits of the merger to such party, as to render inadvisable in its reasonable good faith judgment the consummation of the merger. If any such term, condition or restriction is imposed, either Norwood or North Penn may elect not to consummate the merger. See "-- Conditions to Completing the Merger" on page 66.

The approval of any application merely implies the satisfaction of regulatory criteria for approval, which does not include review of the acquisition from the standpoint of the adequacy of the merger consideration to be received by North Penn shareholders. Furthermore, regulatory approvals do not constitute an endorsement or recommendation of the acquisition.

#### Interests of Certain Persons in the Merger

Share Ownership. On the record date for the special meeting, all persons who served as a director or executive officer of North Penn beneficially owned, in the aggregate, \_\_\_\_\_ shares of North Penn common stock (excluding shares that may be acquired upon the exercise of stock options), representing approximately \_\_\_\_% of the outstanding shares of North Penn common stock.

As described below, certain of North Penn's officers and directors have interests in the merger that are in addition to, or different from, the interests of North Penn's shareholders generally. North Penn's board of directors was aware of these conflicts of interest and took them into account when approving the merger.

Employment Agreements. North Penn has existing employment agreements with Frederick L. Hickman, Thomas J. Dziak and Thomas A. Byrne. These employment agreements require North Penn to make payments and/or provide benefits to its executive officers upon a termination of their employment and, in certain circumstances, upon a termination of employment in connection with or following a change in control of North Penn. The completion of the merger will constitute a change in control for purposes of North Penn's employment agreements. The employment agreements provide that an executive is entitled to change in control compensation if a change in control has occurred and the executive's employment is terminated with two years following the change in control due to (i) the executive's dismissal or (ii) the executive's voluntary resignation following any material demotion, loss of title, office or significant authority or responsibility, material reduction in annual compensation or benefits or relocation of his principal place of employment by more than 25 miles from its location

immediately prior to the change in control. The executive would not be entitled to change in control compensation if his termination is because of his death, disability, retirement or for cause.

Under the employment agreements, if an executive's employment is terminated following the merger under the terms described above, the executive will be entitled to receive a cash payment equal to 2.99 times (in the case of Mr. Hickman and Mr. Dziak) or two times (in the case of Mr. Byrne) the executive's average annual taxable compensation for the five most recent taxable years that the executive has been employed by North Penn. In addition, North Penn would also be obligated to continue and/or pay for the former executive's life, medical and dental coverage for three years (in the case of Mr. Hickman and Mr. Dziak) or two years (in the case of Mr. Byrne).

**Addendums to Employment Agreements.** In connection with the execution of the merger agreement, Mr. Hickman, Mr. Dziak and Mr. Byrne each entered into an addendum to his employment agreement. In the event that the merger agreement is terminated prior to completion of the merger, each of the addendums would terminate and be of no further force and effect. In the addendum to his employment agreement, Mr. Hickman agreed that the maximum change in control severance benefit under his employment agreement will be \$597,344, that additional income generated by the exercise of stock options or the disposition of shares acquired upon the exercise of stock options would not be taken into account in calculating any change in control severance compensation, and that he would execute a full release of claims shortly before completion of the merger.

In the addendum to his employment agreement, Mr. Dziak agreed that he would not compete with Norwood or any of its subsidiaries for a period beginning on the effective date of the merger and ending on the later of four months following the date of the merger or three months following his termination of employment with Norwood, that additional income generated by the exercise of stock options or the disposition of shares acquired upon the exercise of stock options would not be taken into account in calculating any change in control severance compensation, and that he would execute a full release of claims shortly before completion of the merger.

In the addendum to his employment agreement, Mr. Byrne agreed that if he is an employee in good standing with Norwood as of the date that is one month following the effective date of the merger he would receive \$50,000 and if he is an employee in good standing with Norwood as of the date that is 12 months following the effective date of the merger he would receive \$30,000, that he would not compete with Norwood or any of its subsidiaries for a period beginning on the effective date of the merger and ending on the later of one year following the date of the merger or three months following his termination of employment with Norwood, that Norwood would continue to provide certain country club and automobile perquisites following the merger, and that additional income generated by the exercise of stock options or the disposition of shares acquired upon the exercise of stock options would not be taken into account in calculating any change in control severance compensation.

**Reimbursement for Excise Taxes.** Mr. Hickman is also entitled to receive an additional tax indemnification payment (a "gross-up" payment) if payments under the employment agreements or any other payments trigger liability under Sections 280G and 4999 of the Internal Revenue Code for an excise tax on "excess parachute payments." Under applicable law, the excise tax is triggered by change in control related payments that equal or exceed three times the executive's average annual taxable compensation over the five taxable years preceding the change in control. The excise tax equals 20% of the amount of the payment in excess of the executive's average taxable compensation over the preceding five taxable year periods. North Penn (or its successor, here Norwood Financial) is not able to take a federal tax deduction for excess parachute payments.

It is currently anticipated that Mr. Hickman will receive excess parachute payments, and North Penn estimates the amount of the gross-up payment to Mr. Hickman (based on current state and federal tax rates) would be approximately \$\_\_\_\_\_. Such gross-up payments would be in addition to his change in control severance payments noted above.

With respect to the agreements with Mr. Dziak and Mr. Byrne, in the event payments and benefits under the employment agreement, together with other payments and benefits the executive may receive, would constitute an excess parachute payment under Section 280G of the Internal Revenue Code, these payments to the executive will be reduced by the minimum amount necessary to avoid the payments constituting excess parachute payments. As a result of these limitations, after taking into consideration the other change in control benefits described below, the change in control severance benefits payable to Mr. Dziak and Mr. Byrne if they are terminated at the time of the merger would be \$\_\_\_\_\_ and \$\_\_\_\_\_, respectively.

**Supplemental Executive Retirement Agreements.** North Penn Bank has entered into supplemental executive retirement agreements with Mr. Hickman, Mr. Dziak and Mr. Byrne. Under these agreements, upon their separation from service on or after the normal retirement age of 65, Mr. Hickman, Mr. Dziak and Mr. Byrne will receive benefits of \$83,000, \$46,000 and \$43,000 per year, respectively, for 10 years. No benefits are payable under the supplemental executive retirement agreements following termination for cause. If the executive voluntarily terminates employment before his normal retirement age, he will receive an annual retirement benefit based on the liability for the normal retirement benefit accrued by North Penn through the most recent plan year and as is reflected in a schedule to the supplemental executive retirement agreement. In the event the executive is terminated involuntarily before his normal retirement age or terminates employment following a change in control before his normal retirement age, North Penn (or its successor, here Norwood Financial) will pay the executive an annual benefit determined by vesting the executive in the present value of the normal retirement benefit, discounted using a 4.0% discount rate. The completion of the merger will constitute a change in control for purposes of North Penn's supplemental executive retirement agreements.

In connection with the execution of the merger agreement, Mr. Hickman entered into an addendum to his supplemental executive retirement agreement that eliminated the change in control benefit and provided that if he remains employed until the closing of the merger and receives a change in control severance payment under his employment agreement, he will remain entitled to receive the voluntary early termination benefit under the supplemental executive retirement agreement and not the involuntary early termination benefit.

Assuming that each executive is terminated at the effective time of the merger and that the merger is completed in 2011, the retirement benefit for Mr. Hickman, Mr. Dziak and Mr. Byrne will be \$24,286, \$30,975, and \$23,798 per year, respectively, for 10 years beginning 90 days following termination of employment (unless certain Internal Revenue Code provisions regarding deferred compensation apply, in which case any payments due in the first six months following termination would be accumulated and paid on the first day of the seventh month following termination).

**Non-Solicitation and Non-Competition Agreement.** In connection with the execution of the merger agreement, Mr. Hickman entered into a Non-Solicitation and Non-Competition Agreement with Norwood pursuant to which he agreed, for a period of 24 months following the merger, he will not serve as an employee, an officer, a director, a consultant, an agent, partner, an advisory director, a founder or a shareholder or other equity holder in a corporation or other entity or in any other capacity with any business organization that is doing business or intends to do business in the Commonwealth of Pennsylvania in the counties of Lackawanna, Wayne, Pike and Monroe and that is engaged or intends to engage in the provision of financial services to the public, including, but not limited to, accepting retail or



commercial deposit accounts, making loans or offering trust services, commercial banking, mortgage banking, or lease financing, by business entities, including but not necessarily limited to commercial banks, savings associations, trust companies, credit unions and parent companies and subsidiary companies of such business entities, and he also agrees that he will not recruit any Norwood employees or solicit any customers of Norwood. Norwood will pay Mr. Hickman \$15,000 per month for the period of the agreement.

Equity-Based Awards. Pursuant to North Penn's existing equity plans, all unvested options to purchase shares of North Penn common stock will become vested and exercisable upon consummation of the merger. At the closing of the merger, all unexercised options will be cancelled and North Penn will pay each holder an amount equal to the difference between the \$19.12 per share merger consideration and the exercise price per share of each option, net of any cash that must be withheld under federal and state income and employment tax requirements. The following table sets forth the number of unvested options that were held by the executive officers of North Penn and all non-employee directors of North Penn as a group as of January 31, 2011.

Name	Number of Unvested Stock Options	Weighted Average Exercise Price
Frederick L. Hickman	45,174	\$9.12
Thomas J. Dziak	5,151	\$8.84
Thomas A. Byrne	11,620	\$9.21
All non-employee directors as a group	33,858	\$9.22

Pursuant to North Penn's existing equity plans, any vesting conditions applicable to any shares of restricted stock of North Penn will lapse, and such shares of restricted stock will be treated the same as all other shares of North Penn common stock in accordance with the terms of the merger agreement. As of January 31, 2011, the number of unvested shares of restricted North Penn common stock held by each of Mr. Hickman, Mr. Dziak and Mr. Byrne that would vest and become free of restrictions is 19,737, 2,508, and 4,218, respectively. The number of unvested shares of restricted North Penn common stock held by North Penn's six non-employee directors as a group that would vest and become free of restrictions is 15,308.

Termination of North Penn Bank ESOP. North Penn Bank will terminate its employee stock ownership plan upon completion of the merger. All shares remaining after repayment of the outstanding ESOP loan balance ("surplus shares") will be allocated to participants who were employed by North Penn Bank immediately preceding the completion of the merger. The surplus shares will be allocated to the eligible participants, including Mr. Hickman, Mr. Dziak and Mr. Byrne, in proportion to their account balances as of the first day of the ESOP valuation period, to the extent allowed under applicable law and the governing documents of the plan.

Appointment of North Penn Director to the Norwood Financial Board of Directors. Norwood Financial has invited Kevin Lamont, Chairman of North Penn, to serve on the boards of directors of Norwood Financial and Wayne Bank following completion of the merger. See "Management Following the Merger" on Page 164. Mr. Lamont will be entitled to compensation received by other members of the Norwood board of directors. See "Management Following the Merger – Director Compensation."

Continued Director and Officer Liability Coverage. For a period of six years following the effective time of the merger, Norwood Financial has agreed to indemnify and hold harmless the directors and officers of North Penn against all liability arising out of actions or omissions occurring at or before





the effective time of the merger to the same extent as North Penn currently provides for indemnification of its officers and directors. For a period of six years following the effective time of the merger, Norwood Financial has also agreed to maintain in effect North Penn's directors' and officers' liability insurance coverage or provide a policy with comparable coverage; provided, however, if the cost that is necessary to maintain or procure such insurance coverage exceeds 150% of the amount of annual premiums paid by North Penn as of the date of the merger agreement, Norwood Financial will obtain the most advantageous coverage obtainable for a premium equal to such amount.

Payments to North Penn Directors for On-going Cooperation. All other individuals serving on the board of directors of North Penn who are not otherwise eligible for a severance or change in control payment as of the date of the merger agreement shall be entitled to receive, after the effective time of the merger, a retainer in the amount of \$1,000 per month for an 18 month period in exchange for their efforts in promoting the combined entity after the effective time of the merger. Such cooperation includes their agreement not to serve as an employee, an officer, a director, a consultant, an agent, partner, an advisory director, a founder or a shareholder or other equity holder in a corporation or other entity or in any other capacity with any business organization that is doing business or intends to do business in the Commonwealth of Pennsylvania in the counties of Lackawanna, Wayne, Pike and Monroe and that is engaged or intends to engage in the provision of financial services to the public, including, but not limited to, accepting retail or commercial deposit accounts, making loans or offering trust services, commercial banking, mortgage banking, or lease financing, by business entities, including but not necessarily limited to commercial banks, savings associations, trust companies, credit unions and parent companies and subsidiary companies of such business entities, and not to recruit any Norwood employees or solicit any customers of Norwood.

#### Employee Matters

Nothing in the merger agreement shall be construed as constituting an employment agreement between Norwood, Wayne Bank or any of their affiliates and any officer or employee of North Penn or any of its subsidiaries or an obligation on the part of Norwood, Wayne Bank or any of their affiliates to employ any such officers or employees.

In the event that Norwood terminates any of North Penn's health and welfare benefit plans, programs, insurance and other policies, all employees of North Penn or any of its subsidiaries who continue employment with Norwood or any subsidiary of Norwood following the effective time of the merger will become eligible to participate in Norwood's or Wayne Bank's medical, dental, health and disability plans without any gap or interruption in coverage. With respect to each Norwood health plan, Norwood and Wayne Bank shall cause each such plan to (1) waive any waiting period limitation or evidence of insurability requirement under said plans, (2) waive any pre-existing condition limitations under such plans to the extent such conditions for such participant are covered under the applicable North Penn health plan, and (3) credit under such plans any current plan year deductible, co-payment and out-of-pocket expenses incurred by the employees and their covered dependents during the portion of the plan year prior to such participation.

Any employee of North Penn (other than those employees who are a party to an employment, a change of control or other type of agreement with North Penn which provides for severance) whose employment is terminated by North Penn, Norwood or Wayne Bank, absent termination for cause, within 12 months of the effective date of the merger, shall receive severance benefits in accordance with the policy and years of service information set forth in the merger agreement.

### Time of Completion

Unless the parties agree otherwise and unless the merger agreement has otherwise been terminated, the closing of the merger will take place on the 10th business day following the later of (1) the effective date (including the expiration of any applicable waiting period) of the last required regulatory approval, and (2) the date on which the shareholders of North Penn approve the merger agreement.

Norwood and North Penn are working to complete the merger quickly. It is currently expected that the merger will be completed in the second quarter of 2011. However, because completion of the merger is subject to regulatory approvals and other conditions, the parties cannot be certain of the actual timing.

### Conditions to Completing the Merger

Norwood's and North Penn's obligations to consummate the merger are conditioned on the following:

- approval of the merger agreement by North Penn's shareholders;
- receipt of all required regulatory approvals and the expiration of all statutory waiting periods;
- there shall be no actual or threatened causes of action, investigations or proceedings (1) challenging the validity or legality of the merger agreement or the consummation of the merger, or (2) seeking damages in connection with the merger, or (3) seeking to restrain or invalidate the merger; unless actual or threatened causes of action, investigations or proceedings would not have a material adverse effect with respect to the interests of Norwood or North Penn, as the case may be;
- Norwood's registration statement of which this proxy statement/prospectus is a part being effective;
- no party to the merger being subject to any legal order, decree or injunction that prohibits consummating any part of the transaction, and the absence of any statute, rule or regulation that prohibits completion of any part of the transaction; and
- the other party having performed in all material respects its obligations under the merger agreement, the other party's representations and warranties being true and correct as of the effective date of the merger and receipt of a certificate signed by the other party's chief executive officer to that effect.

Norwood's obligations to consummate the merger are also conditioned on the following:

- there shall have been no determination by Norwood that any fact, event, or condition exists or has occurred that would have a material adverse effect on North Penn or the consummation of the transactions contemplated by the merger agreement;
- receipt by North Penn of all consents and approvals from third parties (other than those required from regulatory authorities) required to complete the merger, unless failure to obtain those consents or approvals would not have a material adverse effect on the merger or Norwood after completion of the merger; and

- there shall be no action taken by an regulatory authority, which, in connection with approval of the merger, imposes, in the judgment of Norwood, any material adverse requirement upon Norwood or any Norwood subsidiary, including, without limitation, any requirement that Norwood sell or dispose of any significant amount of assets of North Penn, or any other Norwood subsidiary.

#### Conduct of Business Before the Merger

North Penn has agreed that, until completion of the merger, it and its subsidiaries will:

##### General Business

- conduct its business in the usual, regular and ordinary course consistent with past practice and prudent banking principles;
- use its best efforts to maintain and preserve intact its business organization, employees, goodwill with customers and advantageous business relationships and retain the services of its officers and key employees; and
- except as required by law or regulation, take no action which would adversely affect or delay the ability of the Norwood and North Penn to obtain any consent from any regulatory authority or other approvals required for the consummation of the transactions contemplated by the merger agreement or to perform its respective covenants and agreements under the merger agreement.

North Penn has agreed that, until completion of the merger, unless required by law or permitted by Norwood, neither it nor its subsidiaries will:

##### Indebtedness

- incur any material liabilities or material obligations (other than deposit liabilities and short-term borrowings in the ordinary course of business), whether directly or by way of guaranty, including any obligation for borrowed money, or whether evidenced by any note, bond, debenture, or similar instrument;

##### Capital Stock

- change the number of shares of its authorized, issued or outstanding capital stock (except for the issuance of North Penn common stock issued upon the exercise of outstanding stock options), including any issuance, purchase, redemption, split, combination or reclassification thereof;
- issue or grant any option, warrant, call, commitment, subscription, right or agreement to purchase relating to its authorized or issued capital stock;

- declare, set aside or pay any dividend or other distribution with respect to the outstanding capital stock of North Penn other than the regular quarterly cash dividend of not more than \$0.04 per share;

North Penn cannot guarantee whether all of the conditions to the merger will be satisfied or waived by the party permitted to do so.

#### Acquisitions and Dispositions

- sell, transfer, convey or otherwise dispose of any real property (including “other real estate owned”) or interest therein;
- purchase or otherwise acquire or sell or otherwise dispose of, any assets or incur any liabilities otherwise than in the ordinary course of business;

#### Investments

- acquire or agree to acquire 5% or more of the assets or equity securities of any person or business or acquire direct or indirect control of any person or business (except for foreclosures in the ordinary course of business and after consultation with Norwood);
- enter into any futures contract, option, interest rate caps, interest rate floors, interest rate exchange agreement or other agreement, or take any other action for purposes of hedging the exposure of its interest-earning assets and interest-bearing liabilities to changes in market rates of interest;
- purchase or sell or otherwise acquire any investment securities other than those issued by the U.S. Treasury with a maximum remaining maturity of two years or less;

#### Contracts

- enter into or extend any agreement, lease or license relating to real property (other than capital expenditures permitted under the merger agreement), personal property, data processing or bankcard functions that involves an aggregate of \$25,000 or more;
- waive, release, grant or transfer any material rights of value or modify or change in any material respect any existing agreement or indebtedness to which it is a party, other than in the ordinary course of business consistent with past practice;

#### Loans

- originate, purchase, extend or grant any loan in the principal amount in excess of \$100,000 if such loan is not fully secured or \$400,000 if such loan is fully secured, except for binding obligations as of the date of the merger agreement;

#### Employee Matters

- unless previously disclosed by North Penn, pay any bonuses to any employee, officer, director or other person;
- grant any general increase in compensation or pay any bonuses to its employees as a class or to its officers;



- enter into any new, or amend in any respect any existing, employment, consulting, non-competition or independent contractor agreement with any person;
- alter the terms of any incentive bonus or commission plan;
- adopt any new or materially amend any existing employee benefit plan except as required by law;
- except for the execution of the merger agreement and the consummation of the merger, take any action that would give rise to a right of payment to any individual under an employment agreement or an acceleration of the right to payment to any individual under any employee benefit plan;
- terminate any individual that is a party to an employment contract or change of control agreement prior to the effective time of the merger, other than for “cause” as defined in the applicable agreement;
- make any written communication to employees of North Penn pertaining to compensation or benefit matters affected by the merger or the transactions contemplated by the merger agreement without first providing Norwood with a copy or description of the intended communication;

#### Litigation

- commence any cause of action or proceeding other than in accordance with past practice or settle any action, claim, arbitration, complaint, criminal prosecution, demand letter, governmental or other examination or investigation, hearing, inquiry or other proceeding against it for material money damages or material restrictions upon any of its operations;

#### Governing Documents

- amend its articles of incorporation or bylaws;

#### Deposits

- increase or decrease the rate of interest paid on time deposits or on certificates of deposit, except in a manner and pursuant to policies consistent with North Penn’s past practices;

#### Capital Expenditures

- make any capital expenditures in excess of \$25,000 other than expenditures, necessary to maintain existing assets in good repair;

#### Branches

- file any applications or make any contract with respect to branching by North Penn or acquire or construct, or enter into any agreement to acquire or construct, any interest in real property;

#### Other Agreements

- form any new subsidiary;
- enter into, renew, extend or modify any transaction (other than a deposit transaction) with any affiliate other than pursuant to existing policies;
- make any changes to its existing policies regarding credit, loan loss reserves, loan charge-offs, investments, asset/liability management or other banking policies except as required by changes in applicable law or U.S. generally accepted accounting principles;
- take any action that is intended or may reasonably be expected to result in any of the conditions to the merger not being satisfied; and
- foreclose upon or take a deed or title to any commercial real estate without first conducting a Phase I environmental assessment of the property or if such assessment indicates the presence of an underground storage tank or hazardous material.

#### Covenants of North Penn and Norwood in the Merger Agreement

Agreement Not to Solicit Other Proposals. North Penn has agreed that neither it nor its officers, directors, employees and representatives will: (1) solicit, initiate, encourage or otherwise facilitate any inquiries or the making of any acquisition proposal or offer by a third party; (2) enter into, continue or otherwise participate in discussions or negotiations regarding, an acquisition proposal; or (3) furnish any non-public information or negotiate or enter into any agreement with respect to an acquisition transaction. An acquisition transaction includes a proposal for any of the following:

- a merger or consolidation, or any similar transaction of any company with North Penn (other than the merger with Norwood);
- a purchase, lease or other acquisition of all or substantially all of the assets of North Penn;
- a purchase or other acquisition of beneficial ownership by any person or group of securities representing 25% or more of the voting power of North Penn; or
- a tender or exchange offer to acquire securities representing 25% or more of the voting power of North Penn.

Despite the agreement of North Penn not to solicit other proposals for an acquisition transaction, prior to obtaining shareholder approval of the merger agreement with Norwood, North Penn may negotiate or have discussions with, or provide information to, a third party who makes an unsolicited, written, bona fide proposal for an acquisition transaction not solicited in violation of the merger agreement, provided that North Penn's board of directors:

- after consultation with its legal counsel and financial advisor, in good faith deems such action to be legally necessary for the proper discharge of its fiduciary duties to North Penn's shareholders under applicable law; and
- after consultation with its outside legal counsel and its financial advisor, in good faith reasonably determines that the transaction presented by such unsolicited acquisition





proposal, taking into account all legal, financial and regulatory aspects of the proposal and the person making the proposal, (1) is more favorable from a financial point of view to the North Penn shareholders than the merger with Norwood (taking into account any changes to the financial terms of the merger agreement proposed by Norwood in response to the other proposal) and (2) is reasonably capable of being completed, taking into account all financial, legal, regulatory and other aspects of such proposal (referred to in this document as a “superior proposal”).

If North Penn receives a proposal or information request from a third party or enters into negotiations with a third party regarding a superior proposal, North Penn must immediately notify Norwood and provide Norwood with information about the third party and its superior proposal and keep Norwood fully informed in all material respects of the status and details of such proposal.

**Certain Other Covenants.** The merger agreement also contains other agreements relating to the conduct of Norwood and North Penn before consummation of the merger, including the following:

- each party will give the other party reasonable access during normal business hours to its properties, and shall disclose or make available to the other party and its representatives all books, papers and records relating to the assets, stock, properties, operations, obligations and liabilities of such party;
- each party shall cause to be prepared and filed all required applications and filings with the regulatory authorities which are necessary or contemplated for obtaining the consents of the regulatory authorities or consummation of the merger;
- Norwood was required to prepare the registration statement of which this proxy statement/prospectus forms a part and North Penn agreed to cooperate in its preparation;
- each party will use its best efforts to take all actions and do all things necessary, proper or advisable under applicable laws and regulations, or otherwise, to consummate the merger and the other transactions contemplated by the merger agreement;
- North Penn will make all reasonable efforts to cause its data processing service providers to cooperate with Norwood in connection with the data processing conversion to occur after the effective time of the merger and will permit its employees to be trained in the new system during normal business hours;
- North Penn will invite a representative of Norwood to attend all regular and special meetings of North Penn’s board of directors and committees thereof. North Penn may request that the representative of Norwood recuse himself or herself from any meeting (1) if the merger or any other acquisition transaction is the subject of discussion or (2) to preserve attorney-client privilege with respect to any specific matter;
- North Penn will take all actions necessary to convene a meeting of its shareholders to vote on the merger agreement to be held no later than 70 days after the registration statement is declared effective;
- each party shall have the right to review any filing made with, or written material submitted to, any government agencies in connection with the transactions contemplated by the merger agreement;

- each party will furnish the other with all information concerning itself, its subsidiaries, directors, trustees, officers, shareholders and depositors, and such other matters as may be necessary or advisable in connection with any statement or application made by or on behalf of either party to any governmental body in connection with the transactions, applications or filings contemplated by the merger agreement;
- each party will promptly furnish the other party with copies of written communications received by them or their respective subsidiaries from any government body in respect of the merger;
- North Penn and Norwood will consult with one another prior to issuing any press release or other public disclosure related to the merger;
- North Penn's board of directors will recommend at the meeting of North Penn's shareholders that the shareholders vote to approve the merger agreement and will use its reasonable best efforts to solicit shareholder approval; and
- North Penn and Norwood will cooperate in establishing a retention bonus plan of up to \$50,000 for certain employees of North Penn and North Penn Bank who remain employed at North Penn, Norwood or Wayne Bank for a period of up to six months after the effective time of the merger.

#### Representations and Warranties Made by North Penn and Norwood in the Merger Agreement

North Penn and Norwood have made certain customary representations and warranties to each other in the merger agreement relating to their respective businesses. For information on these representations and warranties, please refer to the merger agreement attached as Annex A. The representations and warranties must be true in all material respects through the completion of the merger. See "-- Conditions to Completing the Merger" on page 66.

The representations and warranties contained in the merger agreement were made only for purposes of the merger agreement and are made as of specific dates, were solely for the benefit of the parties to the merger agreement, and may be subject to limitations agreed to by the contracting parties, including being qualified by disclosures between the parties. These representations and warranties may have been made for the purpose of allocating risk between the parties to the merger agreement instead of establishing these matters as facts, and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to investors as statements of factual information.

#### Terminating the Merger Agreement

The merger agreement may be terminated at any time before the effective time of the merger, as follows:

- by the written mutual consent of Norwood and North Penn;
- by either party, if the shareholders of North Penn fail to approve the merger agreement;
- by either party, if a required regulatory approval, consent or waiver is denied;

- by either party, if the merger is not consummated by October 31, 2011 or other mutually agreed upon date, unless failure to complete the merger by that time is due to a breach of a representation, warranty or covenant by the party seeking to terminate the merger agreement;
- by either party, if the other party materially breaches any representation, warranty, covenant or agreement contained in the merger agreement, or in the event of an inaccuracy of any representation or warranty by the other party, in either case that has not been cured within 30 days following written notice to such party;
- by Norwood, if North Penn fails to hold its shareholder meeting to vote on the merger within the time frame set in the merger agreement;
- by Norwood, if the board of directors of North Penn does not recommend approval of the merger to the North Penn shareholders or withdraws or revises its recommendation in a manner adverse to Norwood;
- by North Penn, if prior to the approval of the merger agreement by the shareholders of North Penn, it receives a superior proposal from a third party that, in the good faith determination of North Penn's board of directors, the board is required to accept in order to comply with its fiduciary duties and Norwood does not make an offer at least as favorable to North Penn within 5 days after notice; or
- by North Penn, at any time during a 5 day period beginning on the date that all required regulatory approvals have been received (the "Determination Date") if both of the following conditions are satisfied:
  - o The average of the daily closing sales prices for the Norwood common stock for the 20 consecutive trading days immediately preceding the Determination Date (the "Norwood Market Value") is less than \$22.40; and
  - o The number obtained by dividing the Norwood Market Value by \$28.00 is less than the number obtained by dividing the average closing prices of the NASDAQ Bank Index for the 20 consecutive trading days immediately preceding the Determination Date divided by the NASDAQ Index Price on December 14, 2010 minus 0.20.

Unless within five business days of notice of such termination, Norwood notifies North Penn that it will increase the exchange ratio for the stock consideration so that the Norwood Market Value is equal to a dollar amount that is the lesser of \$22.40 or the amount obtained by reducing the Initial Norwood Market Value by the percentage change in the NASDAQ Bank Index less 20 percentage points.

#### Termination Fee

The merger agreement requires North Penn to pay Norwood a fee of \$1,125,000 if the merger agreement is terminated in certain circumstances. Specifically, North Penn must pay the termination fee if Norwood terminates the merger agreement as a result of North Penn's failure to hold a shareholder meeting to act upon the merger agreement, or if North Penn's board of directors fails to recommend approval of the merger or upon the withdrawal, qualification or revision of its recommendation to approve the merger. In addition, North Penn is also required to pay the \$1,125,000 termination fee if North Penn

terminates the merger agreement after having received a superior proposal that, in the good faith determination of North Penn's board of directors, the board is required to accept in order to comply with its fiduciary duties.

In addition, if, after a public announcement that another party would like to enter into a transaction with North Penn, Norwood terminates the merger agreement due to the shareholders of North Penn failing to approve the merger or due to a material breach by North Penn of any of its covenants or agreements in the merger agreement, North Penn will be required to pay Norwood a fee of \$500,000. If North Penn enters into a merger agreement with any other party within 18 months of the termination of the merger agreement as a result of the failure of North Penn shareholders to approve the merger agreement, North Penn will be required to pay an additional \$625,000 to Norwood.

#### Expenses

Each of Norwood and North Penn will pay its own costs and expenses incurred in connection with the merger.

#### Changing the Terms of the Merger Agreement

Before the completion of the merger, Norwood and North Penn may agree to waive, amend or modify any provision of the merger agreement.

#### Dissenters' Rights of Appraisal

In accordance with the procedures under Subchapter D of Chapter 15 of the Pennsylvania Business Corporation Law (the "PBCL"), North Penn shareholders are entitled to dissent from approval of the merger agreement and demand payment of the fair value of their shares North Penn common stock. A summary of the rights of dissenting shareholders follows. This summary is qualified in its entirety by reference to the full text of Subchapter D of Chapter 15 of the Pennsylvania Business Corporation Law, which is provided as Annex C to this document. Any holder of shares of North Penn common stock who desires to exercise dissenters rights should review carefully Subchapter D of Chapter 15 of the PBCL and is urged to consult a legal advisor before electing or attempting to exercise those dissenters rights.

General. Subject to the exceptions stated below, North Penn's shareholders who comply with the applicable procedures, which are summarized below, will be entitled to dissenters rights under Subchapter D of Chapter 15 of the PBCL. North Penn shareholders who follow the procedures of Subchapter D of Chapter 15 of the PBCL will be entitled to receive from North Penn the fair value of their shares calculated as of immediately before the effectuation of the merger. Fair value takes into account all relevant factors but excludes any appreciation or depreciation in anticipation of the merger. North Penn shareholders who elect to exercise their dissenters rights must carefully follow with particularity the procedures to preserve those rights under Subchapter D of Chapter 15 of the PBCL or they will lose their dissenters rights.

Shares Eligible for Dissenters Rights. Generally, if an owner of North Penn common stock chooses to assert dissenters rights, the owner must dissent as to all of the shares of North Penn common stock he or she owns. The PBCL distinguishes between record holders and beneficial owners. A holder may assert dissenters rights as to fewer than all the shares of North Penn common stock registered in his or her name only if he or she is not the beneficial owner of the shares of North Penn common stock with respect to which he or she does not exercise dissenters rights.

**Record Holder who is Not the Beneficial Owner.** A record holder may assert dissenters rights on behalf of the beneficial owner. If a holder is a record owner and wishes to exercise dissenters rights on behalf of the beneficial owner, the holder must disclose the name and address of the person or persons on whose behalf he or she dissents. In that event, the record holder's rights will be determined as if the shares to which the record holder has dissented and such shareholder's other shares were registered in the names of different owners.

**Beneficial Owner who is Not the Record Holder.** A beneficial owner of shares of North Penn common stock who is not also the record holder may assert dissenters rights. A person who is a beneficial owner but who is not the record holder who wishes to assert his or her dissenters rights must submit a written consent of the record holder to the Secretary of North Penn no later than the time of the assertion of dissenters rights by the record holder. To accomplish this step, the beneficial owner must make appropriate arrangements with the record owner. A beneficial owner may not dissent with respect to some but less than all shares of North Penn common stock he or she beneficially owns, whether or not the shares so owned by that person are registered in that person's name.

**Dissenters Rights Procedures for North Penn Shareholders.** If a person wishes to exercise dissenters rights, with respect to shares of North Penn common stock, he or she must file a written notice with the Secretary of North Penn prior to the vote on the proposal to approve and adopt the merger agreement of his or her intention to demand that he or she be paid the fair value of his or her shares of North Penn common stock. He or she must not make any change in his or her beneficial ownership of shares of North Penn common stock from the date he or she files the notice until the effective time. He or she must refrain from voting his or her shares "FOR" the merger agreement proposal. A dissenter who fails to follow these procedures in any respect will not acquire any right to payment of the fair value of his or her shares. Neither a proxy nor a vote against the proposed merger will constitute the required notice.

**Notice to Dissenters.** If the North Penn shareholders approve the merger, North Penn will mail a further notice to all dissenting common stock holders who filed a notice of intention to dissent and demand payment of the fair value of their shares prior to the vote on the merger and who refrained from voting in favor of the merger. North Penn expects to mail the notice promptly after the merger. The notice will state where and when a shareholder's demand for payment must be sent and where certificates representing shares of North Penn common stock must be deposited in order to obtain payment. The notice will also supply a form for demanding payment which includes a request for certification of the date on which the holder, or the person on whose behalf the holder dissents, acquired beneficial ownership of the shares of North Penn common stock. The demand form will be accompanied by a copy of Subchapter D of Chapter 15 of the PBCL.

If a person asserts his or her dissenters rights, he or she must ensure that North Penn receives his or her demand form on or before the demand deadline. All mailings to North Penn are at the dissenters' risk. Accordingly, North Penn recommends that a notice of intention to dissent and demand form be sent by certified mail, by overnight courier or by hand delivery.

**Failure to Comply.** If a person fails to file a notice of intention to dissent or fails to complete and return the demand form or fails to deposit certificates as required by the notice to dissenters, each within the specified time periods, that person will lose his or her dissenters rights under Subchapter D of Chapter 15 of the PBCL. The dissenter will retain all rights of a common stock holder, or beneficial owner, until those rights are modified by the effectuation of the merger. Within 60 days after the date set for demanding payment and depositing certificates, if the merger has not been effectuated, North Penn will return any certificates that have been deposited. North Penn may thereafter send a new notice setting a new date for demanding payment and depositing certificates.

Payment of Fair Value by North Penn. Upon timely receipt of the completed demand form, the PBCL requires North Penn to either remit to dissenters who complied with the procedures the amount North Penn estimates to be the fair value for the dissenters' shares of North Penn common stock or give written notice that no such remittance will be made. The remittance or notice will be accompanied by:

the closing balance sheet and statement of income of North Penn for the fiscal year ended not less than 16 months before the date of remittance together with and the latest available interim financial statements;

- a statement of North Penn's estimate of the fair value of the shares of North Penn common stock; and

notice of the right of the dissenter to demand payment or supplemental payment, as the case may be, accompanied by a copy of Subchapter D of Chapter 15 of the PBCL.

If No Payment is Made. If North Penn does not remit the amount of its estimate of the fair value of the shares, it will return any certificates that have been deposited and release the shares of a dissenter from the restriction on transfer imposed as a result of the dissenter's demand for payment. North Penn may make a notation on any such certificates that such demand has been made. If shares with respect to which notation has been so made are transferred, each new certificate issued for such shares shall bear a similar notation, together with the name of the original dissenting holder or owner of the shares. A transferee of such shares will not acquire by transfer any rights in the corporation other than those that the original dissenter had after making demand for payment of their fair value.

Dissenting Shareholder's Estimate of Fair Value. If North Penn gives notice of its estimate of the fair value of the shares of North Penn common stock, without remitting this amount, or remits payment of its estimate of the fair value of the shares of North Penn common stock, and the dissenter believes that the amount remitted or stated is less than the fair value of such shares, the dissenter may send to North Penn his or her own estimate of the fair value of the shares. Such estimate shall be deemed a demand for payment of the amount of the deficiency. If the dissenter does not file his or her estimate within 30 days after the mailing by North Penn of its remittance or notice, the dissenter will only be entitled to the amount stated in the notice or remitted to him or her by North Penn.

Resort to Court for Relief. If, within 60 days after the latest of (i) the closing of the merger, (ii) timely receipt of any demands for payment by a dissenter or (iii) the timely receipt of any dissenter's estimate of fair value, any demands for payment remain unsettled, North Penn may file in court an application for relief, requesting that the court determine the fair value of the shares. There is no assurance that North Penn will file this application. In the court proceeding, all dissenters, wherever residing, whose demands have not been settled will be made parties to the proceeding as in an action against their shares. A copy of the application will be served on each such dissenter. The jurisdiction of the court will be plenary and exclusive. The court may appoint an appraiser to receive evidence and recommend a decision on the issue of fair value. The appraiser will have such power and authority as may be specified in the order of appointment or in any amendment thereof. Each dissenter made a party will be entitled to recover an amount equal to the fair value of the dissenter's shares, or if North Penn previously remitted any amount to the dissenter, any amount by which the fair value of the dissenter's shares is found to exceed the amount previously remitted, in either case plus interest at the rate set forth in Subchapter D of Chapter 15 of the PBCL.

If North Penn fails to file an application for relief, any dissenter who made a demand and who has not already settled his or her claim against North Penn may file an application for relief in the name of



North Penn any time within 30 days after the expiration of the 60-day period described above in which North Penn could have done so. If no dissenter files an application within the 30-day period, each dissenter entitled to file an application shall be paid North Penn estimate of the fair value of the shares and no more, and may bring an action to recover any amount not previously remitted.

**Costs and Expenses of Court Proceedings.** The costs and expenses of the court proceedings, including the reasonable compensation and expenses of the appraiser appointed by the court, will be determined by the court and assessed against North Penn. The court may, however, apportion and assess any part of the costs and expenses of court proceedings as it deems appropriate against all or some of the dissenters who are parties and whose action in demanding supplemental payment the court finds to be in bad faith. If North Penn fails to comply substantially with the requirements of Subchapter D of Chapter 15 of the PBCL, the court may levy fees and expenses of counsel and of experts for the parties as it deems appropriate against North Penn and in favor of any or all dissenters. The court may levy fees and expenses of counsel and experts against either North Penn or a dissenter, if the court finds that a party acted in bad faith. If the court finds that the services of counsel for any dissenter substantially benefited other dissenters similarly situated and should not be assessed against North Penn, it may award counsel reasonable fees to be paid out of the amounts awarded to the dissenters who benefited.

**No Right to an Injunction.** Under the PBCL, a North Penn shareholder has no right to obtain, in the absence of fraud or fundamental unfairness, an injunction against the transaction proposal, nor any right to valuation and payment of the fair value of the holder's shares because of the merger, except to the extent provided by the dissenters rights provisions of Subchapter D of Chapter 15 of the PBCL. The PBCL also provides that, absent fraud or fundamental unfairness, the rights and remedies provided by Subchapter D of Chapter 15 are exclusive.



## SELECTED HISTORICAL FINANCIAL DATA FOR NORWOOD

The following selected financial information for the fiscal years ended December 31, 2009, 2008, 2007, 2006 and 2005 is derived from audited consolidated financial statements of Norwood Financial Corp. The financial information as of and for the nine months ended September 30, 2010 and 2009 is derived from unaudited financial statements. The results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the results of operations for the full year or any other interim period. In the opinion of Norwood's management, this information reflects all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of this data for those dates. You should read this information in conjunction with Norwood's consolidated financial statements and related notes for the three years ended December 31, 2009, and for the nine months ended September 30, 2010, beginning on page F-1 of this proxy statement/prospectus.

	At or for nine months ended			At or for the years ended December 31,			
	September 30, 2010	2009	2009	2008	2007	2006	2005
	(dollars in thousands, except per share data)						
Net interest income	\$ 14,748	\$ 14,282	\$ 19,109	\$ 18,401	\$ 17,272	\$ 16,183	\$ 15,263
Provision for loan losses	730	385	1,685	735	315	220	350
Other income	2,845	3,171	4,929	4,105	3,507	3,517	3,506
Net realized gains (losses) on sales of securities	208	296	463	(18)	17	66	42
Other expenses	9,448	9,769	13,471	12,240	11,341	10,957	10,623
Income before income taxes	7,623	7,395	9,345	9,513	9,140	8,589	7,838
Income tax expense	2,118	2,134	2,282	2,836	2,629	2,679	2,341
Net Income	\$ 5,505	\$ 5,261	\$ 7,063	\$ 6,677	\$ 6,511	\$ 5,910	\$ 5,497
Net income per share-Basic	\$ 1.99	\$ 1.92	\$ 2.57	\$ 2.44	\$ 2.34	\$ 2.11	\$ 1.96
Diluted	1.99	1.90	2.55	2.41	2.30	2.07	1.92
Cash dividends declared	0.84	0.81	1.09	1.02	0.94	0.85	0.71
Dividend pay-out ratio	42.2%	42.2%	42.41%	41.80%	40.17%	40.28%	36.41%
Return on average assets	1.38%	1.39%	1.38%	1.36%	1.39%	1.33%	1.31%
Return on average equity	11.04%	11.51%	11.40%	11.79%	12.10%	11.85%	11.72%
Balances at Period-End							
Total assets	\$ 534,557	\$ 514,867	\$ 529,696	\$ 504,296	\$ 480,610	\$ 454,356	\$ 433,556
Loans receivable	358,354	359,482	363,474	349,404	331,296	315,567	290,890
Allowance for loan losses	5,513	4,663	5,453	4,233	4,081	3,828	3,669
Total deposits	398,652	382,863	391,473	359,635	370,000	358,103	340,603
Shareholders' equity	68,443	63,736	64,471	58,690	55,819	52,231	48,108
Trust assets under management	109,253	99,042	99,373	90,069	101,714	96,879	86,972
Book value per share	\$ 24.79	\$ 23.07	\$ 23.25	\$ 21.45	\$ 20.27	\$ 18.67	\$ 17.07

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Average equity to average assets	12.21%	12.05%	12.09%	11.57%	11.48%	11.23%	11.19%
Tier 1 Capital to risk-adjusted assets	18.14	16.90	16.97%	16.22%	16.26%	15.67%	15.29%
Total Capital to risk-adjusted assets	19.45	18.20	18.27%	17.50%	17.60%	16.99%	16.63%
Allowance for loan losses to total loans	1.54	0.88	1.50%	1.21%	1.23%	1.21%	1.26%
Non-performing assets to total assets	0.82	0.73	1.02%	0.54%	0.03%	0.09%	0.08%

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## SELECTED HISTORICAL FINANCIAL DATA FOR NORTH PENN

The following selected financial information for the fiscal years ended December 31, 2009, 2008 and 2007 is derived from audited consolidated financial statements of North Penn Bancorp, Inc. The financial information as of and for the nine months ended September 30, 2010 and 2009 is derived from unaudited financial statements. The results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the results of operations for the full year or any other interim period. In the opinion of North Penn's management, this information reflects all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of this data for those dates. You should read this information in conjunction with North Penn's consolidated financial statements and related notes for the year ended December 31, 2009, and for the nine months ended September 30, 2010, beginning on page F-50 of this proxy statement/prospectus.

(In thousands, except per share data)	Nine Months Ended September 30,		Year Ended December 31,		
	2010 (Unaudited)	2009 (Unaudited)	2009	2008	2007
<b>Financial Condition Data:</b>					
Total assets	\$164,505	\$151,478	\$156,327	\$138,990	\$122,532
Investment securities	15,497	19,548	19,398	20,293	13,366
Loans receivable, net	119,696	109,450	114,546	106,106	97,247
Deposits	136,548	119,349	124,055	99,153	83,683
Borrowings	7,000	12,000	12,000	19,648	17,879
Total stockholders' equity	19,908	19,185	19,270	19,298	20,184
<b>Operating Data:</b>					
Interest income	\$6,010	\$5,714	\$7,675	\$7,691	\$7,452
Interest expense	1,910	2,368	3,126	3,311	3,860
Net interest income	4,100	3,346	4,549	4,380	3,592
Provision for loan losses	334	135	475	31	86
Net interest income after provision for loan losses	3,766	3,211	4,074	4,349	3,506
Other income	401	332	412	338	473
Other expenses	3,107	3,016	3,614	4,180	3,586
Income (loss) before taxes	1,060	527	872	507	393
Income tax expense (benefit)	235	160	85	153	92
Net income (loss)	\$825	\$367	\$787	\$354	\$301
<b>Per Share Data:</b>					
Earnings per share, basic	\$0.63	\$0.26	\$0.57	\$0.23	\$0.20
Earnings per share, diluted	0.62	0.26	0.57	0.23	0.20
Dividends per share	0.17	0.09	0.12	0.12	0.12

	Nine Months Ended		Year Ended December 31,						
	September 30,		2009		2008		2007		
	2010	2009							
Performance Ratios (1):									
Return on average assets	0.69	% 0.33	%	0.53	%	0.28	%	0.25	%
Return on average equity	5.64	2.54		4.04		2.34		2.49	
Interest rate spread (2)	3.67	3.11		2.95		3.09		2.77	
Net interest margin (3)	3.86	3.42		3.33		3.63		3.34	
Dividend payout ratio	20.73	37.60		19.19		53.95		58.80	
Efficiency ratio (4)	67.03	78.19		70.72		85.87		85.12	
Average interest-earning assets to average interest-bearing liabilities	111.15	113.24		116.97		120.32		116.69	
Average equity to average assets	12.25	13.00		13.01		11.82		10.22	
Asset Quality Ratios:									
Allowance for loan losses as a percent of total loans	1.37	1.12		1.28		1.09		1.19	
Allowance for loan losses as a percent of nonperforming loans	90.28	82.87		83.65		105.69		309.79	
Non-performing loans as a percent of total loans	1.52	1.36		1.53		1.03		0.38	
Non-performing assets as a percent of total assets	1.36	0.99		1.19		0.80		0.39	

(1) Performance ratios for the nine months ended September 30, 2010 and 2009 are annualized.

(2) Represents the difference between the tax-equivalent weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.

(3) Represents tax-equivalent net interest income as a percent of average interest-earning assets.

(4) Represents noninterest expense divided by the sum of tax-equivalent net interest income and other income.

## PRO FORMA DATA

The unaudited pro forma combined condensed consolidated financial information has been prepared using the acquisition method of accounting, giving effect to Norwood's proposed merger with North Penn. Under this method, North Penn's assets and liabilities as of the date of the acquisition will be recorded at their respective fair values and added to those of Norwood. Any difference between the purchase price for North Penn and the fair value of the identifiable net assets acquired (including core deposit intangibles) will be recorded as goodwill. The goodwill resulting from the acquisition will not be amortized to expense, but instead will be reviewed for impairment at least annually and to the extent goodwill is impaired, its carrying value will be written down to its implied fair value and a charge will be made to earnings. Core deposit and other intangibles with estimated useful lives recorded by Norwood in connection with the acquisition will be amortized to expense over their estimated useful lives. The financial statements of Norwood issued after the acquisition will reflect the results attributable to the acquired operations of North Penn beginning on the date of completion of the acquisition. The unaudited pro forma combined condensed consolidated statement of financial condition combines the historical financial information of Norwood and North Penn as of September 30, 2010.

The following unaudited pro forma combined consolidated balance sheet as of September 30, 2010 combines the historical financial statements of Norwood and North Penn. The unaudited pro forma financial statements give effect to the proposed acquisition as if the acquisition occurred on September 30, 2010 with respect to the balance sheet, and at the beginning of the period for the nine months ended September 30, 2010 and for the year ended December 31, 2009, with respect to the statement of income for the year. The unaudited pro forma financial statements were prepared with Norwood as the acquirer and North Penn as the acquiree under the acquisition method of accounting. Accordingly, the consideration paid by Norwood to complete the acquisition of North Penn will be allocated to North Penn's assets and liabilities based upon their estimated fair values as of the date of completion of the acquisition. The allocation is dependent upon certain valuations and other studies that have not been finalized at the time of the acquisition announcement; however, preliminary valuations based on the fair value of the acquired assets and liabilities have been estimated and included in the unaudited pro forma financial statements.

The final allocation of the purchase price will be determined after the merger is completed and after completion of thorough analyses to determine the fair value of North Penn's tangible and identifiable intangible assets and liabilities as of the date the merger is completed. Increases or decreases in the estimated fair values of the net assets as compared with the information shown in the unaudited pro forma combined condensed consolidated financial information may change the amount of the purchase price allocated to goodwill and other assets and liabilities and may impact Norwood's statement of income due to adjustments in yield and/or amortization of the adjusted assets or liabilities. Any changes to North Penn shareholders' equity, including results of operations from September 30, 2010 through the date the merger is completed, will also change the purchase price allocation, which may include the recording of a lower or higher amount of goodwill. The final adjustments may be materially different from the unaudited pro forma adjustments presented herein. The pro forma calculations, shown herein, assume a closing price of \$28.00, which represents the closing price of Norwood's common stock on September 30, 2010.

Norwood anticipates that the merger with North Penn will provide the combined company with financial benefits that include reduced operating expenses. The pro forma information, while helpful in illustrating the financial characteristics of the combined company under one set of assumptions, does not reflect the benefits of expected cost savings or opportunities to earn additional revenue and, accordingly, does not attempt to predict or suggest future results. It also does not necessarily reflect what the historical



results of the combined company would have been had our companies been combined during these periods.

The unaudited pro forma combined consolidated financial information has been derived from and should be read in conjunction with the historical consolidated financial statements and the related notes of Norwood and North Penn, which are included elsewhere in this proxy statement/prospectus. See “Index to Financial Statements” on page 185.

The unaudited pro forma stockholders’ equity and net income are qualified by the statements set forth under this caption and should not be considered indicative of the market value of Norwood common stock or the actual or future results of operations of Norwood for any period. Actual results may be materially different than the pro forma information presented.

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Unaudited Condensed Pro Forma Balance Sheets as of September 30, 2010

	Norwood Financial Corp.	North Penn Bancorp	Pro Forma Adjustments		Proforma Combined
	(In Thousands, Except Per Share Data)				
<b>Assets</b>					
Cash and due from banks	\$ 9,057	\$ 2,825	\$ -		\$ 11,882
Interest bearing deposits with other banks	7,696	56	-		7,752
Federal funds sold	3,000	15,888	-		18,888
Cash and cash equivalents	19,753	18,769	-		38,522
Investment securities available for sale	139,308	16,640	(12,194)	(4)	143,754
Investment securities held to maturity	169	-	-		169
Loans	358,354	121,363	1,670	(5)	481,387
Credit fair value of loans purchased	-	-	(2,667)	(6)	(2,667)
Loans, net of fair value adjustments	358,354	121,363	(997)		478,720
Allowance for possible loan losses	(5,513)	(1,667)	1,667	(6)	(5,513)
Loans, net	352,841	119,696	670		473,207
Investment in FHLB Stock, at cost	3,538				3,538
Bank Premises, Equipment, Furniture	5,012	3,860	279	(10)	9,151
Bank owned life insurance	8,161	3,124	-		11,285
Accrued interest receivable	2,342	754	-		3,096
Foreclosed real estate owned	748	-	-		748
Goodwill	26	-	8,834	(1)	8,860
Identifiable intangible assets	247	47	1,541	(3)	1,835
Other assets	2,412	1,615	178	(9)	4,205
<b>Total Assets</b>	<b>\$ 534,557</b>	<b>\$ 164,505</b>	<b>\$ (692)</b>		<b>\$ 698,370</b>
<b>Liabilities</b>					
Non-interest bearing demand	\$ 66,331	\$ 7,160	\$ -		\$ 73,491
Interest-bearing	332,321	129,388	921	(7)	462,630
<b>Total Deposits</b>	<b>398,652</b>	<b>136,548</b>	<b>921</b>		<b>536,121</b>
Fed Funds Purchased and Repo's	24,530	-	-		24,530
Other Borrowed Money	38,000	7,000	732	(8)	45,732
Accrued interest payable	1,652	232	-		1,884
Other Liabilities	3,280	817	2,658	(11)	6,755



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Total liabilities	466,114	144,597	4,311	615,022
Equity Capital				
Preferred Stock	-	-	-	-
Common Stock	284	158	(105) (1)(2)	337
Additional Paid-in Capital	9,815	13,695	1,157 (2)	24,667
Retained Earnings	57,642	9,142	(9,142) (2)	57,642
Less: cost of treasury stock/	)	)	)	)
ESOP	(2,437	(2,616	2,616 (2)	(2,437
Less: ESOP	-	(853)	853 (2)	-
A c c u m u l a t e d O t h e r	)	)	)	)
Comprehensive Income	3,139	382	(382) (2)	3,139
Total Stockholders' Equity	68,443	19,908	(5,003)	83,348
Total liabilities and equity	534,557	\$ 164,505	\$ (692)	\$ 698,370
Per Share Data				
Shares Outstanding	2,760,895	1,285,148	(752,833) (1)	3,293,210
Book Value Per Share	\$ 24.79	\$ 16.01		\$ 25.31

## Unaudited Pro Forma Combined Statement of Operations for the Nine Months Ended September 30, 2010

	Norwood Financial Corp.	North Penn Bancorp (In Thousands, Except Per Share Data)	Pro Forma Adjustment	Pro Forma Combined
<b>Interest Income</b>				
Loans receivable, including fees	\$ 15,894	\$ 5,380	\$ (1) (5)(6)	\$ 21,273
Interest on investment securities	3,477	619	(413) (4)	3,684
Other	43	11	-	54
Total interest income	19,414	6,010	(413)	25,011
<b>Interest Expense</b>				
Deposits	3,332	1,502	(345) (7)	4,489
Short-term borrowings	87	-	-	87
Other borrowings	1,247	408	(110) (8)	1,546
Total interest expense	4,666	1,910	(455)	6,121
Net interest income	14,748	4,100	42	18,890
Provision for loan losses	730	334	-	1,064
Net interest income after provision for loan losses	14,018	3,766	42	17,826
<b>Other Income</b>				
Service charges and fees	1,680	120	-	1,800
Income from fiduciary activities	300	-	-	300
Net realized gains on sales of securities	380	8	-	388
Gain on sale of loans and servicing rights	208	123	-	331
Other	485	150	-	635
Total other income	3,053	401	-	3,454
<b>Other Expense</b>				
Salaries and employee benefits	4,844	1,760	-	6,604
Occupancy, furniture & equipment, net	1,190	428	-	1,618
Data processing related	607	78	-	685
Taxes, other than income	374	64	-	438
Professional fees	358	185	-	543
FDIC insurance assessment	357	165	-	522
Other real estate owned	32	10	-	42
Amortization of intangibles	13	7	210 (3)	230
Merger related expenses	-	20	-	20
Other operating expenses	1,673	390	-	2,063

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Total other expenses	9,448	3,107	210	12,765
Income before taxes	7,623	1,060	(168)	8,515
Applicable income taxes	2,118	235	(57) (9)	2,296
Net income	\$ 5,505	\$ 825	\$ (111)	\$ 6,219
Per Share Data				
Basic earnings per share	\$ 1.99	\$ 0.63		\$ 1.89
Diluted earnings per share	\$ 1.99	\$ 0.62		\$ 1.87
Basic EPS weighted average shares outstanding	2,762	1,306	) (774	3,294
Diluted EPS weighted average shares outstanding	2,767	1,325	) (774	3,318

## Unaudited Pro Forma Combined Statement of Operations for the Year Ended December 31, 2009

	Norwood Financial Corp.	North Penn Bancorp	Pro Forma Adjustments		Pro Forma Combined
			(In Thousands)		
<b>Interest Income</b>					
Loans receivable, including fees \$	21,523	\$ 6,878	\$ (1)	(5)(6)	\$ 28,400
Interest on investment securities	5,293	797	(550)	(4)	5,540
Other	19	-	-		19
Total interest income	26,835	7,675	(551)		33,969
<b>Interest Expense</b>					
Deposits	5,765	2,495	(461)	(7)	7,800
Short-term borrowings	292	-	-		292
Other borrowings	1,669	631	(146)	(8)	2,154
Total interest expense	7,726	3,126	(607)		10,246
Net interest income	19,109	4,549	56		23,714
Provision for loan losses	1,685	475	-		2,160
Net interest income after provision for loan losses	17,424	4,074	56		21,554
<b>Other Income</b>					
Service charges and fees	2,476	244	-		2,720
Income from fiduciary activities	354	-	-		354
Net realized gains on sales of securities	463	8	-		471
Gain on sale of loans and servicing rights	481	6	-		487
Other	1,618	154	-		1,772
Total other income	5,392	412	-		5,804
<b>Other Expense</b>					
Salaries and employee benefits	6,829	2,129	-		8,958
Occupancy, furniture & equipment, net	1,591	656	-		2,247
Data processing related	788	115	-		903
Taxes, other than income	484	86	-		570
Professional fees	411	408	-		819
FDIC insurance assessment	710	240	-		950
Other real estate owned	436	-	-		436
Amortization of intangibles	52	-	280	(3)	332
Merger related expenses	-	-	-		-
Other operating expenses	2,170	(20)	-		2,150
Total other expenses	13,471	3,614	280		17,365

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Income before taxes	9,345	872	(225)	9,993
Applicable income taxes	2,282	85	(76) (9)	2,291
Net income	\$ 7,063	\$ 787	\$ (148)	\$ 7,702
Per Share Data				
Basic earnings per share	\$ 2.57	\$ 0.57		\$ 2.35
Diluted earnings per share	\$ 2.55	\$ 0.57		\$ 2.33
Basic EPS weighted average shares outstanding	2,750	1,376	(844)	3,282
Diluted EPS weighted average shares outstanding	2,766	1,383	(844)	3,305

NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS

- 1) The acquisition will be effected by the issuance of shares of Norwood common stock and cash to North Penn's shareholders. Each share of North Penn common stock will be exchanged for either 0.6829 shares of Norwood common stock or \$19.12 in cash. All shareholder elections will be subject to allocation and proration procedures set forth in the merger agreement which are intended to ensure that, in the aggregate, the total cash consideration (for common shares, options and restricted stock awards) will be \$12,194,000. The shares of Norwood common stock issued illustrated in this pro forma were assumed to be recorded at \$28.00 per share, the closing sale price of Norwood common stock on September 30, 2010. The final accounting purchase price assigned to record the shares issued in the acquisition will be based on the closing price of Norwood common stock on the closing date of the acquisition. Norwood and North Penn cannot predict what the value or price of Norwood's common stock will be at the closing of the transaction or how the value or price of Norwood's stock may trade at any time, including the date hereof.

The final allocation of the purchase price will be determined after the acquisition is completed and additional analyses are performed to determine the fair values of North Penn tangible and identifiable intangible assets and liabilities as of the date the acquisition is completed. Changes in the fair value of the net assets of North Penn as of the date of the acquisition will likely change the amount of purchase price allocable to excess purchase price. The final adjustments may be materially different from the unaudited pro forma adjustments presented herein. The unaudited pro forma financial information has been prepared to include the estimated adjustments necessary to record the assets and liabilities of North Penn at their respective fair values and represents management's best estimate based upon the information available at this time. These pro forma adjustments included herein are subject to change as additional information becomes available and as additional analyses are performed. Such adjustments, when compared to the information shown in this document, may change the amount of the purchase price allocated to goodwill while changes to other assets and liabilities may impact the statement of income due to adjustments in the yield and/or amortization/accretion of the adjusted assets and liabilities.

The total estimated purchase price of for the purpose of this pro forma financial information is \$27.1 million. The following table provides the calculation and allocation of the purchase price used in the pro forma financial statements and a reconciliation of pro forma shares to be outstanding:

Summary of Purchase Price Calculation and Goodwill Resulting from Merger  
And Reconciliation of Pro Forma Shares Outstanding at September 30, 2010

(\$ in thousands except per share data)	September 30, 2010
Purchase Price Consideration in Common Stock (1)	
North Penn common shares settled for stock	779,492
Exchange Ratio	0.6829
Norwood shares to be issued	532,315
Value assigned to Norwood common share	\$ 28.00
Purchase price assigned to North Penn common shares exchanged for Norwood stock	\$ 14,905
Purchase Price Consideration - Cash for Common Stock (1)	
North Penn shares exchanged for cash	463,769
Purchase price paid to each North Penn common share exchanged for cash	\$ 19.12
Purchase price assigned to North Penn common shares exchanged for cash	8,867
Purchase Price Consideration - Cash for Outstanding Options	
North Penn options outstanding	157,246
Average strike price	\$ 9.28
Options settlement price	\$ 19.12
In-the-money value for North Penn options cashed out	\$ 9.84
Purchase price assigned to North Penn options settled for cash	1,551
Purchase Price Consideration - Cash for Unallocated ESOP Shares (1)	
North Penn Unallocated ESOP Shares Outstanding	92,868
Unallocated ESOP Shares settlement price per share	\$ 19.12
Purchase price assigned to North Penn unallocated ESOP shares settled for cash	1,776
 Total Purchase Price	 27,099
Net Assets Acquired:	
North Penn shareholders' equity	\$ 19,908
North Penn goodwill and intangibles	-
Estimated adjustments to reflect assets acquired at fair value:	
Investments	-
Loans	(997)
Allowance for loan losses	1,667
Core deposit intangible	1,541

Premises & equipment	279	
Deferred tax assets	178	
Estimated adjustments to reflect liabilities acquired at fair value:		
Time deposits	(921)	
Borrowings	(732)	
Transaction merger liabilities accrued at closing	(2,658)	18,265
Goodwill resulting from merger		\$ 8,834

(1) Common shares outstanding at September 30, 2010 total 1,285,148 which include 92,868 unallocated ESOP shares. The agreement requires the unallocated ESOP shares to be paid in cash. The agreement also requires 50,981 of restricted stock awards that are not included in the outstanding shares to be paid out in accordance with the election procedures and are included above as shares to be settled for cash and common stock.



- 2) Adjustment to reflect the issuance of common shares of Norwood common stock with a \$0.10 par value in connection with the acquisition and the adjustments to shareholders' equity for the reclassification of North Penn historical equity accounts (common stock, accumulated other comprehensive loss, cost of treasury stock, and undivided profits) into surplus and adjustment for goodwill created in the transaction.
- 3) Adjustment for core deposit intangible to reflect the fair value of this asset and the related amortization and the related amortization adjustment based upon an expected life of 10 years. The amortization of the core deposit intangible is expected to increase pro forma pre-tax interest expense by \$280 thousand in the first year following consummation.
- 4) Since all investments were recorded at fair value at September 30, 2010, no balance sheet adjustment is necessary. Income statement adjustments reflect prospective reclassification of existing AFS adjustment to an amortizing premium which is amortized based on the expected life. This investment adjustment is expected to decrease pro forma pre-tax interest income by \$185 thousand in the first year following consummation. Balance sheet adjustment also includes \$12.2 million pro forma adjustments to reflect the use of cash to fund the acquisition. Lost interest income of \$365 thousand is expected, assuming a 3% investment rate.
- 5) Adjustment of \$1.7 million to reflect fair values of loans based on current interest rates of similar loans. The adjustment will be substantially recognized over approximately the next 7 years using an amortization method based upon the expected life of the loans and is expected to decrease pro forma pre-tax interest income by \$418 thousand following consummation.
- 6) Adjustment of \$1.7 million to reflect the general credit risk of the loan portfolio and a specific credit quality fair value adjustment of \$1.0 million. Included is the reversal of the North Penn allowance for loan losses as of September 30, 2010 in accordance with acquisition method of accounting for the acquisition. The general credit adjustment will be substantially recognized over approximately the next 7 years using an amortization method based upon the expected life of the loans. The general credit adjustment is expected to increase pro forma pre-tax interest income by \$417 thousand in the first year following consummation. No pro forma earnings impact was assumed from the specific credit adjustments.
- 7) Adjustment of \$0.9 million to reflect the fair values of certain interest-bearing time deposit liabilities based on current interest rates for similar instruments. The adjustment will be recognized using an amortization method based upon the maturities of the deposit liabilities. This adjustment is expected to decrease pro forma pre-tax interest expense by \$461 thousand following consummation.
- 8) Adjustment of \$0.7 million to reflect fair values of long-term debt which consists primarily of FHLB advances at various terms and maturities. The adjustment will be substantially recognized using an amortization method based upon the maturities of the debt. This adjustment is expected to decrease pro forma pre-tax interest expense by \$146 thousand following consummation.
- 9) Adjustment to reflect the net deferred tax at a rate of 34% related to fair value adjustments on the balance sheet and an effective tax rate of 34% for book tax expense. It is noted that a tax benefit was not taken for certain acquisition obligations and costs that were considered to be not tax deductible.
- 10) Adjustment of \$0.3 million to reflect increase in fair value for premises. The amortization of the fair value adjustment is presented over a 30 year period. The adjustment is expected to increase pro forma occupancy and equipment expense by \$9 thousand following consummation.



- 11) Adjustment relates to recognition of estimated merger obligations and cost of \$2.7 million pre-tax, and \$2.2 million after-tax, expected merger related costs assumed to be recorded as a liability on the closing date.

## COMPARISON OF SHAREHOLDER RIGHTS

### General

Norwood and North Penn are incorporated under the laws of the Commonwealth of Pennsylvania and, accordingly, the rights of Norwood shareholders and North Penn shareholders are governed by the laws of the Commonwealth of Pennsylvania. As a result of the merger, North Penn shareholders who receive shares of Norwood common stock will become shareholders of Norwood. Thus, following the merger, the rights of North Penn shareholders who become Norwood shareholders in the merger will continue to be governed by the laws of the Commonwealth, and will also then be governed by Norwood's articles of incorporation and Norwood's bylaws.

### Comparison of Shareholders' Rights

Set forth below is a summary comparison of material differences between the rights of a Norwood shareholder under Norwood's articles of incorporation and the Norwood's bylaws (right column), and the rights of a shareholder under North Penn's articles of incorporation and North Penn's bylaws (left column). The summary set forth below is not intended to provide a comprehensive discussion of each company's governing documents but rather to highlight certain areas where there are differences. This summary is qualified in its entirety by reference to the full text of Norwood's articles of incorporation and Norwood's bylaws, and North Penn's articles of incorporation and North Penn's bylaws.

North Penn Bancorp, Inc.

Norwood Financial Corp.

### CAPITAL STOCK Authorized Capital

80 million shares of common stock, par value \$0.10 per share, 20 million shares of preferred stock, without par value. As of January 31, 2011, there were 1,332,660 shares of North Penn common stock issued and outstanding, and no shares of preferred stock issued and outstanding.

10 million shares of common stock, par value \$0.10 per share, 5 million shares of preferred stock without par value. As of January 31, 2011, there were 2,760,895 shares of Norwood common stock issued and outstanding and an additional 532,315 shares are estimated to be issued in the merger, and no shares of preferred stock issued and outstanding.

**Preferred Stock.** North Penn's articles of incorporation authorize the board of directors, without further shareholder action, to issue up to 20 million shares of preferred stock, in one or more series, and determine by resolution any designations, preferences, qualifications, privileges, limitations, restrictions, or special or relative rights of additional series. The rights of preferred shareholders may supersede the rights of common

**Preferred Stock.** Norwood's articles of incorporation authorize the board of directors, without further shareholder action, to issue up to 5 million shares of preferred stock, in one or more series, and determine by resolution any designations, preferences, qualifications, privileges, limitations, restrictions, or special or relative rights of additional series. The rights of preferred shareholders may supersede the rights of

shareholders.

common shareholders.

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North Penn Bancorp, Inc.

Norwood Financial Corp.

#### BOARD OF DIRECTORS

##### Number of Directors; Classification of Board

North Penn's articles provide that the number of directors on the board shall be not less than 7 nor more than 20 as is provided for from time to time in accordance with the bylaws. The bylaws currently provide that there shall be 8 members of the board. The board of directors is divided into three classes with the members of each class elected for three year terms.

Norwood's articles of incorporation provide that its board of directors shall have not less than 5 nor more than 15 members as provided in the bylaws. The bylaws currently provide that there shall be nine members of the board. The size of the board will be increased by one member following the completion of the merger in order to add Mr. Lamont to the board. As with North Penn, the board of directors is divided into three classes with the members of each class elected for three year terms.

##### Qualification of Directors

North Penn's bylaws provide that each director must reside in a county with the Commonwealth of Pennsylvania in which North Penn Bank maintains an office or in any adjacent county within the Commonwealth of Pennsylvania. Directors' terms in office end at the first annual meeting following the director's 75th birthday and no person 75 years of age is eligible for election, reelection, appointment or reappointment to the board.

Norwood's bylaws do not require that directors be residents of the Commonwealth of Pennsylvania but do require that each director own at least 12 shares of the common stock of Norwood. Such shares must be kept on deposit in the vault of Norwood.

North Penn's bylaws also provide for a minimum share ownership of at least 1,000 shares to be purchased within 6 months of becoming a director.

North Penn's bylaws further provide that a person who serves as a director or management official of any other depository institution is not eligible to serve and restricts individuals who have been indicted or every convicted of certain types of crimes or been subject, within the past ten years, to certain types of regulatory actions or agreements or is nominated by someone who is otherwise disqualified to

serve.

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North Penn Bancorp, Inc.

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#### ACTIONS BY SHAREHOLDERS Annual Meeting of Shareholders

North Penn's bylaws provide that the annual meeting of shareholders must be held within 150 days after the end of North Penn's fiscal year.

Norwood's bylaws provide that the annual meeting shall be held on such date or time as may be determined by the board of directors.

#### Special Meetings of Shareholders

Special meetings of the shareholders may only be called by a resolution adopted by a majority of the whole board of directors.

Special meetings of the shareholders may be called by (i) the majority vote of the board of directors, (ii) the Chairman or the President, or (iii) shareholders entitled to cast at least 50% of the votes that all shareholders are entitled to cast.

#### Action by Shareholders Without a Meeting

North Penn's articles of incorporation prohibit the taking of any action by shareholders without a meeting or by written consent.

Norwood's articles of incorporation permit shareholder action by written consent. In order to be effective, the consent must be signed by shareholders who would have been entitled to cast the minimum number of votes that would be necessary to authorize the action if a meeting was held. If the action is taken by less than unanimous consent, the action may not become effective until after at least 10 days' written notice of the action has been given to each shareholder entitled to vote thereon who has not consented thereto.

#### Record Dates

North Penn's bylaws provide that record dates for determining who may vote at annual or special meetings of shareholders or who may receive a dividend must be not fewer than 10 nor more than 60 days prior to the date on which the particular action requiring a record date.

Norwood's bylaws provide that record dates for determining who may vote at annual or special meetings of shareholders or who may receive a dividend must be not more than 90 days prior to the date on which the particular action requiring a record date.

#### Voting Limitation

North Penn's articles of incorporation include a provision

Neither Norwood's articles of incorporation nor its bylaws include any similar provision.

restricting the voting rights of any beneficial owner owning shares in excess of 10% of the outstanding shares of North Penn common stock.



North Penn Bancorp, Inc.

Norwood Financial Corp.

Approval of Certain Business Combinations

North Penn's articles of incorporation include a provision requiring the affirmative vote of 80% of the outstanding shares to approve any business combination unless the business combination has been approved by two-thirds of the entire board of directors. If approved by the board, the business combination need only receive the approval of shareholders specified by Pennsylvania law.

Norwood's articles of incorporation also include a provision requiring an 80% approval vote for business combinations. As with North Penn, this supermajority vote requirement is not applicable if first approved by the board although the approval requirement is two-thirds of the entire board of directors if approved before there is any controlling person (defined as a shareholder owning 10% or more of the outstanding shares) or a majority of the continuing directors if after there is a controlling person. In addition, the supermajority vote would not apply if the terms of the business combination satisfy certain fair price provisions.

EVALUATION OF OFFERS

North Penn's articles of incorporation include a provision that permits the board of directors, when evaluating business combinations or similar takeover attempts, to give due consideration to all relevant factors, including, without limitation, the social and economic effect of acceptance of the offer on its customers, employees and communities in which it operates and certain other considerations.

Neither Norwood's articles of incorporation nor its bylaws include any similar provision.

DISGORGEMENT BY CONTROLLING SHAREHOLDERS  
FOLLOWING TAKEOVER ATTEMPTS

North Penn does not have any provision of this type in its articles of incorporation although it is subject to the statutory provision which is substantially similar (See "Statutory Anti-Takeover Provisions" below)

Norwood's articles of incorporation include a provision requiring that any profit made by a shareholder owning in excess of 10% of the outstanding shares upon the sale of the shares is recoverable by Norwood if the shares are sold within certain time limitations set forth in the articles.

AMENDMENT OF ARTICLES OF INCORPORATION

North Penn's articles of incorporation require a supermajority vote (80%) to amend certain of the articles or to adopt new articles inconsistent with the specified articles. The articles requiring supermajority vote relate to preemptive rights, elimination of director liability, indemnification, shareholder meetings and proposals, the limitation on voting rights in excess of 10%, business combinations, shareholders and amendment of evaluation of takeover. Norwood's articles of incorporation also require a supermajority vote (80%) to amend certain of the articles. These articles relate to the board of directors, preemptive rights, elimination of director liability, indemnification, shareholder meetings and proposals, approval of business combinations, disgorgement of profits by certain controlling shareholders and amendment of evaluation of takeover.

North Penn Bancorp, Inc.

Norwood Financial Corp.

proposals, and amendments to the articles of incorporation and bylaws.

Aside from these provisions and amendments for which no shareholder vote is required under Pennsylvania law, amendments to the articles must be approved by a majority of the shares entitled to vote generally in the election of directors.

the articles of incorporation and bylaws.

Aside from these provisions, all amendments to the articles must first be approved by the board of directors and then approved by a majority of the shares entitled to vote generally in the election of directors.

#### AMENDMENT OF BYLAWS

North Penn's articles permit both the board of directors and shareholders to amend the bylaws. If amended by the board, the amendment must be approved by majority of the directors then in office. If by shareholders, the amendment must be approved by at least 80% of the outstanding shares of stock entitled to vote in the election of directors as well as such additional vote of any preferred shareholders to the extent required by the terms of the series.

Norwood's bylaws also may be amended in the same manner as North Penn.

#### STATUTORY ANTI-TAKEOVER PROVISIONS

Under Pennsylvania business corporation law, certain anti-takeover provisions apply to Pennsylvania registered corporations (e.g., publicly traded companies) including those relating to (1) control share acquisitions, (2) disgorgement of profits by certain controlling persons, (3) business combination transactions with interested shareholders, and (4) the rights of shareholders to demand fair value for their stock following a control transaction. Pennsylvania law allows corporations to opt-out of these anti-takeover sections. North Penn has not opted out of any of these provisions so they are all applicable.

Norwood has opted out of the control share acquisition statute but the other statutory anti-takeover provisions are applicable to it as well.

#### DESCRIPTION OF NORWOOD CAPITAL STOCK

Norwood is authorized to issue 10,000,000 shares of common stock, par value \$0.10 per share, and 5,000,000 shares of preferred stock no par value. As of February 7, 2011, the most recent practicable trading day before this proxy statement/prospectus was finalized, there were 2,768,804 shares of Norwood common stock outstanding. Norwood has no outstanding shares of preferred stock. Each share of Norwood common stock has the same relative rights as, and is identical in all respects with, each other share of common stock.

The common stock of Norwood represents nonwithdrawable capital, is not an account of an insurable type, and is not insured by the FDIC or any other government agency.

#### Common Stock

**Dividends.** Norwood may pay dividends out of statutory surplus or from net earnings if, as and when declared by its board of directors. The payment of dividends by Norwood is subject to limitations that are imposed by law and applicable regulation. The holders of common stock of Norwood will be entitled to receive and share equally in dividends as may be declared by the board of directors of Norwood out of funds legally available therefor. If Norwood issues shares of preferred stock, the holders thereof may have a priority over the holders of the common stock with respect to dividends.

**Voting Rights.** The holders of common stock of Norwood have exclusive voting rights in Norwood. They elect Norwood's board of directors and act on other matters as are required to be presented to them under Pennsylvania law, or as are otherwise presented to them by the board of directors. Generally, each holder of common stock is entitled to one vote per share and will not have any right to cumulate votes in the election of directors. If Norwood issues shares of preferred stock, holders of the preferred stock may also possess voting rights. Certain matters require an 80% shareholder vote.

**Liquidation.** In the event of liquidation, dissolution or winding up of Norwood, the holders of its common stock would be entitled to receive, after payment or provision for payment of all its debts and liabilities, all of the assets of Norwood available for distribution. If preferred stock is issued, the holders thereof may have a priority over the holders of the common stock in the event of liquidation or dissolution.

**Preemptive Rights.** Holders of the common stock of Norwood will not be entitled to preemptive rights with respect to any shares that may be issued. The common stock is not subject to redemption.

#### Preferred Stock

None of the shares of Norwood's authorized preferred stock are outstanding. Preferred stock may be issued with preferences and designations as the board of directors may from time to time determine. Norwood's board of directors may, without shareholder approval, issue shares of preferred stock with voting, dividend, liquidation and conversion rights that could dilute the voting strength of the holders of the common stock and may assist management in impeding an unfriendly takeover or attempted change in control.

### CERTAIN ANTI-TAKEOVER PROVISIONS OF NORWOOD'S ARTICLES OF INCORPORATION AND BYLAWS

The following discussion is a general summary of the material provisions of Norwood's articles of incorporation and bylaws and certain other regulatory provisions that may be deemed to have an "anti-takeover" effect. The following description of certain of these provisions is necessarily general and, with respect to provisions contained in Norwood's articles of incorporation and bylaws, reference should be made in each case to the document in question.

Norwood's articles of incorporation and bylaws contain a number of provisions relating to corporate governance and rights of shareholders that might discourage future takeover attempts. As a result, shareholders who might desire to participate in such transactions may not have an opportunity to do so. In addition, these provisions will also render the removal of the board of directors or management of Norwood more difficult.



The following description is a summary of the provisions of the articles of incorporation and bylaws. See “Where You Can Find More Information” in the forepart of this proxy statement/prospectus as to how to obtain a copy of these documents.

**Directors.** The board of directors is divided into three classes. The members of each class will be elected for a term of three years and only one class of directors will be elected annually. Thus, it would take at least two annual elections to replace a majority of Norwood’s board of directors. Further, the bylaws impose notice and information requirements in connection with the nomination by shareholders of candidates for election to the board of directors or the proposal by shareholders of business to be acted upon at an annual meeting of shareholders.

**Prohibition of Cumulative Voting.** The articles of incorporation prohibit cumulative voting for the election of directors.

**Restrictions on Removing Directors from Office.** The articles of incorporation provides that directors may only be removed for cause. “Cause” is defined in the articles of incorporation as being declared of unsound mind by an order of a court, convicted of a felony or of an offense punishable by imprisonment for a term of more than one year, or being deemed liable by a court for gross negligence or misconduct in the director’s duties to Norwood. At least 30 days’ prior notice to the director must be given.

**Authorized but Unissued Shares.** Norwood has authorized but unissued shares of common and preferred stock. The articles of incorporation authorize 5,000,000 shares of serial preferred stock. Norwood is authorized to issue preferred stock from time to time in one or more series subject to applicable provisions of law, and the board of directors is authorized to fix the designations, and relative preferences, limitations, voting rights, if any, including, without limitation, offering rights of such shares (which could be multiple or as a separate class). In the event of a proposed merger, tender offer or other attempt to gain control of Norwood that the board of directors does not approve, it might be possible for the board of directors to authorize the issuance of a series of preferred stock with rights and preferences that would impede the completion of the transaction. An effect of the possible issuance of preferred stock, therefore, may be to deter a future attempt to gain control of Norwood. Norwood’s board of directors has no present plan or understanding to issue any preferred stock.

**Amendments to Articles of Incorporation and Bylaws.** Amendments to the articles of incorporation must be approved by Norwood’s board of directors and also by a majority of the outstanding shares of Norwood’s voting stock; provided, however, that approval by at least 80% of the outstanding voting stock is generally required to amend the following provisions:

- The provision establishing the board of directors, the classified terms, procedures for removal and procedures for nomination of directors;
- Preemptive rights;
- Elimination of director liability;
- Indemnification;
- Meetings of shareholders and shareholder proposals;
- Approval of business combinations;





- Disgorgement of profits by certain controlling persons following a takeover attempt; and
- The requisite shareholder vote to approve amendments to the articles of incorporation and bylaws.

#### Anti-takeover Provisions Under the Pennsylvania Business Corporation Law

Under Pennsylvania business corporation law, certain anti-takeover provisions apply to Pennsylvania registered corporations (e.g., publicly traded companies) including those relating to (1) control share acquisitions, (2) disgorgement of profits by certain controlling persons, (3) business combination transactions with interested shareholders, and (4) the rights of shareholders to demand fair value for their stock following a control transaction. Pennsylvania law allows corporations to opt-out of these anti-takeover sections. Norwood is a registered corporation and has opted out only of the control share acquisition provisions. A general summary of the applicable anti-takeover provisions is set forth below.

**Disgorgement of Profits by Certain Controlling Persons.** Pennsylvania law regarding disgorgement of profits by certain controlling persons applies in the event that (1) any person or group publicly discloses that the person or group may acquire control of the corporation, or (2) a person or group acquires (or publicly discloses an intent to acquire) 20% or more of the voting power of the corporation and, in either case, sells shares within 18 months thereafter. Any profits from sales of equity securities of the corporation received by the person or group during such 18-month period will belong to the corporation if the securities that were sold were acquired during the 18-month period or within 24 months prior thereto.

**Business Combination Transactions with Interested Shareholders.** Pennsylvania law regarding business combination transactions with interested shareholders provides that a person who acquires the direct or indirect beneficial ownership of shares entitled to cast at least 20% of the votes entitled to be cast for the election of directors or who is an affiliate or associate of such corporation and was the beneficial owner, directly or indirectly, of shares entitling that person to cast at least 20% of the votes at any time within the five year period immediately prior to the date in question becomes an “interested shareholder.” A corporation subject to this provision may not effect mergers or certain other business combinations with the interested shareholder for a period of five years, unless:

- the business combination or the acquisition of stock by means of which the interested shareholder became an interested shareholder is approved by the corporation’s board of directors prior to such stock acquisition;
- the business combination is approved by the affirmative vote of the holders of all the outstanding common shares of the corporation; or
- the business combination is approved by the affirmative vote of the holders of all the outstanding common shares of the corporation; or the business combination is approved by the affirmative vote of the holders of a majority of all shares entitled to vote, excluding votes of shares held by the interested shareholders, and at the time of such vote, the interested shareholder is the beneficial owner of at least 80% of the voting shares of the corporation. This exception applies only if the value of the consideration to be paid by the interested shareholder in connection with the business combination satisfies certain fair price requirements.

After the five-year restricted period, an interested shareholder of the corporation may engage in a business combination with the corporation if (1) the business combination is approved by the affirmative



vote of a majority of the shares other than those beneficially owned by the interested shareholder and its affiliates, or (2) the merger is approved at a shareholders meeting and certain fair price requirements are met.

#### Change of Control Regulations

The Change In Bank Control Act provides that no person, acting directly or indirectly or through or in concert with one or more other persons, may acquire control of a bank holding company unless the Federal Reserve has been given 60 days prior written notice. For this purpose, the term “control” means the acquisition of the ownership, control or holding of the power to vote 25% or more of any class of a bank holding company’s voting stock, and the term “person” includes an individual, corporation, partnership, and various other entities. In addition, an acquiring person is presumed to acquire control if the person acquires the ownership, control or holding of the power to vote of 10% or more of any class of the holding company’s voting stock if (a) the bank holding company’s shares are registered pursuant to Section 12 of the Exchange Act or (b) no other person will own, control or hold the power to vote a greater percentage of that class of voting securities. Accordingly, the prior approval of the Federal Reserve would be required before any person could acquire 10% or more of the common stock of Norwood.

The Bank Holding Company Act provides that no company may acquire control of a bank directly or indirectly without the prior approval of the Federal Reserve. Any company that acquires control of a bank becomes a “bank holding company” subject to registration, examination and regulation by the Federal Reserve. Pursuant to federal regulations, the term “company” is defined to include banks, corporations, partnerships, associations, and certain trusts and other entities, and “control” of a bank is deemed to exist if a company has voting control, directly or indirectly of at least 25% of any class of a bank’s voting stock, and may be found to exist if a company controls in any manner the election of a majority of the directors of the bank or has the power to exercise a controlling influence over the management or policies of the bank. In addition, a bank holding company must obtain Federal Reserve approval prior to acquiring voting control of more than 5% of any class of voting stock of a bank or another bank holding company.

An acquisition of control of a bank that requires the prior approval of the Federal Reserve under the Bank Holding Company Act is not subject to the notice requirements of the Change In Bank Control Act. Accordingly, the prior approval of the Federal Reserve under the Bank Holding Company Act would be required (a) before any bank holding company could acquire 5% or more of the common stock of Norwood and (b) before any other company could acquire 25% or more of the common stock of Norwood.

### BUSINESS OF NORWOOD

#### General

Norwood, a Pennsylvania corporation, is the holding company for Wayne Bank. On March 29, 1996, Wayne Bank completed a holding company reorganization and became a wholly owned subsidiary of Norwood. As of September 30, 2010, Norwood had total assets of \$534.6 million, deposits of \$398.6 million, and stockholders’ equity of \$68.4 million. Norwood’s ratio of average equity to average assets was 12.21%, 12.09%, 11.57% and 11.48% for the nine months ended September 30, 2010 and fiscal years 2009, 2008 and 2007, respectively.

Wayne Bank is a Pennsylvania chartered commercial bank headquartered in Honesdale, Pennsylvania. Wayne Bank was originally chartered on February 17, 1870 as Wayne County Savings Bank. Wayne County Savings Bank changed its name to Wayne County Bank and Trust in December

1943. In September 1993, Wayne Bank adopted the name Wayne Bank. Wayne Bank's deposits are currently insured to applicable limits by the Deposit Insurance Fund ("DIF") as administered by the Federal Deposit Insurance Corporation ("FDIC"). Wayne Bank is regulated by the Pennsylvania Department of Banking ("PDB") and the FDIC.

Wayne Bank is an independent community bank with five offices in Wayne County, three offices in Pike County and three offices in Monroe County. Wayne Bank offers a wide variety of personal and business credit services and trust and investment products and real estate settlement services to the consumers, businesses, nonprofit organizations, and municipalities in each of the communities that Wayne Bank serves. Wayne Bank primarily serves the Pennsylvania counties of Wayne, Pike and Monroe, and to a much lesser extent, the counties of Lackawanna and Susquehanna. In addition, Wayne Bank operates eleven automated teller machines, one in each of its branch locations.

Norwood's main office is located at 717 Main Street, Honesdale, Pennsylvania and its telephone number is (570) 253-1455. Norwood maintains a website at [www.waynebank.com](http://www.waynebank.com). Information on our website should not be treated as part of this Annual Report on Form 10-K. Norwood makes copies of its SEC filings available free of charge as soon as reasonably practicable after they are filed, through a link on its website to the SEC's website.

### Competition

The competition for deposit products comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional banks in Norwood's market area of Wayne, Pike and Monroe Counties, Pennsylvania. Based on data compiled by the FDIC as of June 30, 2010 (the latest date for which data is available), Wayne Bank had the third largest share of FDIC-insured deposits in Wayne County with approximately 19.2%, third largest in Pike County with 18.6%, and 10th in Monroe County with 2.0%. This data does not reflect deposits held by credit unions with which Wayne Bank also competes. Deposit competition also includes a number of insurance products sold by local agents and investment products such as mutual funds and other securities sold by local and regional brokers. Loan competition varies depending upon market conditions and comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, multi-state regional banks, and mortgage bankers.

### Lending Activities

Wayne Bank's loan products include loans for personal and business use. Personal lending includes mortgage lending to finance principal residences and to a lesser extent second home dwellings. The products include fixed rate mortgage products with terms up to 30 years which may be sold, in the secondary market through the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Bank of Pittsburgh (FHLB), or held in Wayne Bank's portfolio subject to the extent consistent with our asset/liability management strategies. Fixed-rate home equity loans are originated on terms up to 180 months, as well as offering a home equity line of credit tied to prime rate. Wayne Bank to a lesser extent also offers indirect dealer financing of automobiles (new and used), boats, and recreational vehicles through a limited network of dealers in Northeast Pennsylvania, but is not aggressively growing this portfolio. At September 30, 2010, there were \$7.9 million of indirect loans in the portfolio.

Commercial loans and commercial mortgages are provided to local small and mid-sized businesses at a variety of terms and rate structures. Commercial lending activities include lines of credit, revolving credit, term loans, mortgages, various forms of secured lending and a limited amount of letter of credit facilities. The rate structure may be fixed, immediately repricing tied to the prime rate or adjustable at set intervals.



Wayne Bank's construction lending has primarily involved lending for commercial construction projects and for single-family residences. All loans for the construction of speculative sale homes have a loan value ratio of not more than 80%. For both commercial and single-family projects loan proceeds are disbursed during the construction phase according to a draw schedule based on the stage of completion. Construction projects are inspected by contracted inspectors or bank personnel. Construction loans are underwritten on the basis of the estimated value of the property as completed. For commercial projects, Wayne Bank typically also provides the permanent financing after the construction period, as a commercial mortgage.

Wayne Bank also, from time to time originates loans secured by undeveloped land. Land loans granted to individuals have a term of up to 5 years. Land loans granted to developers may have an interest only period during development. The substantial majority of land loans have a loan-to-value ratio not exceeding 75%. Wayne Bank has limited its exposure to land loans but may expand its lending on raw land, as market conditions allow, to qualified borrowers experienced in the development and sale of raw land.

Loans involving construction financing and loans on raw land have a higher level of risk than loans for the purchase of existing homes since collateral values, land values, development costs and construction costs can only be estimated at the time the loan is approved. Wayne Bank has sought to minimize its risk in construction lending and in lending for the purchase of raw land by offering such financing primarily to builders and developers to whom Wayne Bank has loaned funds in the past and to persons who have previous experience in such projects. Wayne Bank also limits construction lending and loans on raw land to its market area, with which management is familiar.

Adjustable-rate loans decrease the risks associated with changes in interest rates by periodically repricing, but involve other risks because as interest rates increase, the underlying payments by the borrower increase, thus increasing the potential for payment default. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate may also be limited by the maximum periodic interest rate adjustment permitted in certain adjustable-rate mortgage loan documents, and, therefore is potentially limited in effectiveness during periods of rapidly rising interest rates. These risks have not had an adverse effect on Wayne Bank.

Consumer lending, including indirect financing provides benefits to Wayne Bank's asset/liability management program by reducing Wayne Bank's exposure to interest rate changes, due to their generally shorter terms. Such loans may entail additional credit risks compared to owner-occupied residential mortgage lending especially when unsecured or secured by collateral such as automobiles that depreciate rapidly. As a result, Wayne Bank has de-emphasized the indirect lending product line.

Commercial lending including real-estate related loans entail significant additional risks when compared with residential real estate and consumer lending. For example, commercial loans typically involve larger loan balances to single borrowers or groups of related borrowers. The payment experience on such loans typically is dependent on the successful operation of the project and these risks can be significantly impacted by the cash flow of the borrowers and market conditions for commercial office, retail, and warehouse space. In periods of decreasing cash flows, the commercial borrower may permit a lapse in general maintenance of the property causing the value of the underlying collateral to deteriorate. The liquidation of commercial property is often more costly and may involve more time to sell than residential real estate. Wayne Bank offsets such factors with requiring more owner equity, a lower loan to value ratio and by obtaining the personal guaranties of the principals. In addition, a majority of Wayne Bank's commercial real estate portfolio is owner occupied property.

Due to the type and nature of the collateral, consumer lending generally involves more credit risk when compared with residential real estate lending. Consumer lending collections are typically dependent on the borrower's continuing financial stability, and thus, are more likely to be adversely affected by job loss, divorce, illness and personal bankruptcy. In most cases, any repossessed collateral for a defaulted consumer loan will not provide an adequate source of repayment of the outstanding loan balance. The remaining deficiency is usually turned over to a collection agency.

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

#### Loan Solicitation and Processing

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

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

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

Loan Portfolio Composition. Set forth below is selected data relating to the composition of Wayne Bank's loan portfolio at the dates indicated.

	As of September 30, 2010		2009		2008		As of December 31, 2007		2006		2005	
	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
	(dollars in thousands)											
Commercial, Financial and Agricultural	\$ 24,645	6.9	\$ 24,116	6.6	\$ 25,886	7.4	\$ 29,159	8.8	\$ 34,019	10.8	\$ 26,755	9.0
Real Estate-Construction	11,633	3.2	14,405	4.0	14,856	4.2	20,404	6.2	18,955	6.0	5,944	2.2
Real Estate-Mortgage	308,380	85.9	310,584	85.3	292,893	83.8	263,481	79.5	241,423	76.4	234,200	80.0
Consumer Loans to Individuals	14,171	4.0	14,850	4.1	16,087	4.6	18,526	5.5	21,520	6.8	24,353	8.0
Unearned income and deferred fees	(475)		(481)		(318)		(274)		(350)		(362)	
Allowance for loan losses	(5,513)		(5,453)		(4,233)		(4,081)		(3,828)		(3,669)	
	\$ 352,841		\$ 358,021		\$ 345,171		\$ 327,215		\$ 311,739		\$ 287,221	



Maturities and Sensitivities of Loans to Changes in Interest Rates. The following table sets forth maturities and interest rate sensitivity for selected categories of loans as of December 31, 2009. Scheduled repayments are reported in the maturity category in which payment is due. Demand loans, loans having no stated schedule of repayments and no stated maturity and overdrafts are reported as due in one year or less.

	One Year or Less	After One to Five Years	Over Five Years	Total
	(in thousands)			
Commercial, Financial and Agricultural	\$ 6,524	\$ 9,748	\$ 7,844	\$ 24,116
Real Estate - Construction	14,405	—	—	14,405
Total	\$ 20,929	\$ 9,748	\$ 7,844	\$ 38,521
Loans with fixed rates	\$ 9,982	\$ 7,789	\$ 4,225	\$ 21,996
Loans with floating rates	10,947	1,959	3,619	16,525
Total	\$ 20,929	\$ 9,748	\$ 7,844	\$ 38,521

Non-Performing Assets. The following table sets forth information regarding non-accrual loans, foreclosed real estate owned and loans that are 90 days or more delinquent but on which Wayne Bank was accruing interest at the dates indicated. For the nine months ended September 30, 2010 and year ended December 31, 2009, interest income that would have been recorded on loans accounted for on a non-accrual basis under the original terms of such loans was \$269,000 and \$188,000, respectively, of which \$82,000 and \$4,000, respectively, was collected.

	At September 30, 2010	2009	2008	2007	2006	2005
	As of December 31, (dollars in thousands)					
Non-accrual loans:						
Commercial and all other	\$ 18	\$ —	\$ —	\$ —	\$ —	\$ —
Real estate	2,871	4,916	2,087	109	392	330
Consumer	762	—	—	2	17	11
Total	3,651	4,916	2,087	111	409	341
Accruing loans which are contractually past-due 90 days or more:						
Commercial and all other	—	9	—	—	—	—
Real estate	—	90	—	49	—	—
Consumer	—	—	—	3	—	12
Total	—	99	—	52	—	12
Total non-performing loans	3,651	5,015	2,087	163	409	353
Foreclosed real estate	748	392	660	—	—	—
Total non-performing assets	\$ 4,399	\$ 5,407	\$ 2,747	\$ 163	\$ 409	\$ 353
Total non-performing loans to total loans	1.02%	1.38%	0.60%	0.05%	0.13%	0.12%

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Total non-performing loans to total assets	0.68%	0.95%	0.41%	0.03%	0.09%	0.08%
Total non-performing assets to total assets	0.82%	1.02%	0.54%	0.03%	0.09%	0.08%

The recorded investment in impaired loans, not requiring an allowance for loan losses was \$4,516,000 (net of a charge-off against the allowance for loan losses of \$210,000) at September 30, 2010 compared to \$6,962,000 (net of a charge-off against the allowance for loan losses of \$154,000) and \$2,976,000 at December 31, 2009 and 2008, respectively. The recorded investment in impaired loans requiring an allowance for loan losses was \$8,827,000 (net of a charge-off against the allowance for loan losses of \$480,000) at September 30, 2010 compared to \$1,065,000 (net of charge-off against the allowance for loan losses of \$480,000) and \$-0- at December 31, 2009 and 2008. For the nine months ended September 30, 2010 and 2009 and for the years ended December 31, 2009, 2008 and 2007, the average recorded investment in these impaired loans was \$8,893,000, \$3,204,000, \$3,585,000, \$3,311,000 and \$3,127,000, respectively, and the interest income recognized on these impaired loans was \$575,000, \$149,000, \$139,000, \$143,000 and \$290,000, respectively.

Potential Problem Loans. As of September 30, 2010, there were no loans not previously disclosed, where known information about possible credit problems of borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms.

Analysis of the Allowance for Loan Losses. The following table sets forth information with respect to Wayne Bank's allowance for loan losses for the years indicated:

	Nine Months Ended September 30,		Year Ended December 31,				
	2010	2009	2009	2008	2007	2006	2005
	(dollars in thousands)						
Total loans receivable net of unearned income	\$ 358,354	\$ 359,482	\$ 363,474	\$ 349,404	\$ 331,296	\$ 315,567	\$ 290,890
Average loans receivable	355,368	354,775	356,345	335,137	323,444	301,533	274,053
Allowance balance at beginning of period	\$ 5,453	\$ 4,233	\$ 4,233	\$ 4,081	\$ 3,828	\$ 3,669	\$ 3,448
Charge-offs:							
Commercial and all other	(85)	(17)	(17)	(7)	—	—	(4)
Real Estate	(543)	(60)	(358)	(465)	(4)	—	(6)
Consumer	(62)	(113)	(139)	(171)	(117)	(150)	(200)
Total	(690)	(190)	(514)	(643)	(121)	(150)	(210)
Recoveries:							
Commercial and all other	-	4	11	—	—	18	12
Real Estate	1	4	4	1	2	2	18
Consumer	19	27	34	59	54	65	46
Leases	-	-	--	—	3	4	5
Total	20	35	49	60	59	89	81

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Net Charge-offs	(670)	(155)	(465)	(583)	(62)	(61)	(129)
Provision Expense	730	585	1,685	735	315	220	350
Allowance balance at \$ end of period	5,513	\$ 4,663	\$ 5,453	\$ 4,233	\$ 4,081	\$ 3,828	\$ 3,669
Allowance for loan losses as a percent of total loans outstanding	1.54%	1.30 %	1.50%	1.21%	1.23%	1.21%	1.26%
Net loans charged off as a percent of average loans outstanding	0.25%	0.06 %	0.13%	0.17%	0.02%	0.02%	0.05%

Allocation of the Allowance For Loan Losses. The following table sets forth the allocation of Wayne Bank's allowance for loan losses by loan category and the percent of loans in each category to total loans at the date indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which credit losses may occur. The total allowance is available to absorb losses from any type of loan.

	As of September 30, 2010		2009		2008		As of December 31, 2007		2006		2005	
	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans
Commercial, financial and agricultural	\$ 530	6.9%	\$333	6.6%	\$491	7.4%	\$ 413	8.8%	\$ 505	10.8%	\$ 427	9.2%
Real estate – construction	116	3.2	136	4.0	138	4.2	148	6.2	44	6.0	36	2.0
Real estate – mortgage	4,509	85.9	4,748	85.3	3,315	83.8	2,939	79.5	2,667	76.4	2,713	80.4
Consumer loans to individuals	358	4.0	236	4.1	289	4.6	362	5.5	388	6.8	442	8.4
General Risk Allocation	—	—	—	—	—	—	219	—	224	—	51	—
Total	\$ 5,513	100.0 %	\$4,533	100.0%	\$2,333	100.0%	\$ 4,081	100.0%	\$ 3,828	100.0%	\$ 3,669	100.0%

(dollars in thousands)

## Investment Activities

General. Norwood maintains a portfolio of investment securities consisting principally of obligations of the U.S. Government and its agencies including mortgage-backed securities and obligations of states, counties and municipalities including school districts. To a lesser extent, Norwood also has corporate debt obligations in the portfolio as well as a portfolio of equity instruments of other financial services companies. Norwood considers its investment portfolio a source of earnings and liquidity. Investment securities may also be pledged to secure public deposits and customer repurchase agreements.

Securities Portfolio. Carrying values of securities at the dates indicated are as follows:

	As of September 30, 2010		2009	As of December 31, 2008		2007
			(dollars in thousands)			
Securities: (carrying value)						
U.S. Government agencies	\$ 30,722	\$	39,772	\$ 35,813	\$	41,508
State and political subdivisions	48,915		32,343	25,916		22,622
Corporate obligations	4,306		5,240	5,625		4,994
Mortgage-backed securities	54,789		53,154	62,318		54,082
Equity securities	745		776	1,155		1,486
Total Securities	\$ 139,477	\$	131,285	\$ 130,827	\$	124,692
Fair Value of Securities	\$ 139,485	\$	131,299	\$ 130,840	\$	124,708

Maturity Distribution of Securities. The following table sets forth certain information regarding carrying values, weighted average yields, and maturities of Norwood's securities portfolio as of September 30, 2010. Yields on tax-exempt securities are stated on a fully taxable equivalent basis using a Federal tax rate of 34%. Actual maturities may differ from contractual maturities as certain instruments have call features which allow prepayment of obligations. Maturity on the mortgage-backed securities is based upon contractual terms, the average life may differ as a result of changes in cash flow. Equity securities with no stated maturity are classified as "one year or less."

	One Year or Less		After One Through Five Years		After Five Through Ten Years		After Ten Years		Total Investment Securities	
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield
(dollars in thousands)										
U.S. Government agencies	\$ —	—%	\$ 26,678	2.26%	\$ 4,044	2.63%	\$ —	—%	\$ 30,722	2.31%
State and political subdivision	—	—%	4,364	4.84%	15,948	5.59%	28,603	5.83%	48,915	5.66%
C o r p o r a t e obligations	1,020	4.91%	3,286	5.10%	—	—%	—	%	4,306	5.06%
Mortgage-backed securities	169	3.73%	477	5.16%	17,381	3.34%	36,762	2.89%	54,789	3.06%
Equity securities	745	—%	—	—%	—	—%	—	—%	745	—%
Total Investment Securities	\$ 1,934	2.92%	\$ 34,805	2.89%	\$ 37,373	4.22%	\$ 65,365	4.18%	\$ 139,477	3.85%

## Deposit Activities

General. Wayne Bank provides a full range of deposit products to its retail and business customers. These include interest-bearing and noninterest bearing transaction accounts, statement savings and money market accounts. Certificate of deposit terms range up to 5 years for retail instruments. Wayne Bank has no brokered deposits. Wayne Bank participates in the Jumbo CD (\$100,000 and over) markets with local municipalities and school districts which are typically priced on a competitive bid basis. Other services Wayne Bank offers its customers on a limited basis include cash management, direct deposit, Remote Deposit Capture and Automated Clearing House (ACH) activity. Wayne Bank operates eleven automated teller machines and is affiliated with the STAR and MoneyPass ATM networks. Internet banking including bill-pay is offered through the website at [www.waynebank.com](http://www.waynebank.com).

The following table sets forth information regarding deposit categories of Norwood.

	Nine Months Ended September 30, 2010		2009		Years Ended December 31, 2008		2007	
	Average Balance	Rate Paid	Average Balance	Rate Paid	Average Balance	Rate Paid	Average Balance	Rate Paid
	(dollars in thousands)							
Non-interest bearing demand	\$ 61,819	%	\$ 59,224	—%	\$ 59,759	—%	\$ 56,523	—%
Interest-bearing demand	38,381	0.11	35,808	0.10	36,839	0.10	36,594	0.10
Money Market	68,612	0.82	63,160	1.10	65,519	2.15	53,798	3.37
Savings	48,260	0.23	44,526	0.35	44,510	0.47	45,858	0.47
Time	179,546	2.08	174,201	2.80	160,462	3.81	172,986	4.57
Total	\$ 396,618		\$ 376,919		\$ 367,089		\$ 365,759	

Maturities of Time Deposits. The following table indicates the amount of Wayne Bank's time deposits of \$100,000 or more by time remaining until maturity as of September 30, 2010.

Maturity Period	Amount (dollars in thousands)
Within three months	\$ 7,535
Over three through six months	8,404
Over six through twelve months	18,366
Over twelve months	16,832
	\$ 51,137





## Short-Term Borrowings

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

	Nine Months Ended		Years Ended December 31,		
	September 30,		2009	2008	2007
	2010	2009	2009	2008	2007
	(dollars in thousands)				
Short term borrowings:					
Average balance during the year	\$ 23,958	\$ 26,040	\$ 26,402	\$ 32,238	\$ 22,443
Maximum month-end balance during the year	27,810	35,323	35,323	42,061	33,024
Average interest rate during the year	0.36%	0.88%	1.11%	2.14%	4.15%
Total short-term borrowings at end of the period	\$ 24,529	\$ 19,554	\$ 25,803	\$ 38,126	\$ 26,686
Weighted average interest rate at the end of the period	0.40%	1.18%	0.56%	1.11%	3.60%

## Trust Activities

Wayne Bank operates a Wealth Management/Trust Department which provides estate planning, investment management and financial planning to customers for which it is generally compensated based on a percentage of assets under management. As of September 30, 2010, Wayne Bank had \$109.3 million of assets under management compared to \$99.4 million and \$90.1 million, respectively, as of December 31, 2009 and 2008. The increase is partially due to improvement in stock market performance which can affect the value of a customer's investment portfolio.

## Subsidiary Activities

Wayne Bank, a Pennsylvania chartered bank, is the only wholly owned subsidiary of Norwood. Norwood Investment Corp. (NIC), a Pennsylvania Corporation incorporated in 1996 and a Pennsylvania licensed insurance agency, is a wholly-owned subsidiary of Wayne Bank. NIC's business is annuity and mutual fund sales and discount brokerage activities primarily to customers of Wayne Bank. The annuities, mutual funds and other investment products are not insured by the FDIC or any other government agency. They are not deposits, obligations of or guaranteed by any bank. The securities are offered through Invest Financial a registered broker/dealer. NIC generated gross revenues for Norwood of \$112,000 in 2009, compared to \$105,000 in 2008 which is included in Other Income.

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

WTRO Properties Inc., a Pennsylvania Corporation, is a wholly-owned real estate subsidiary of Wayne Bank established to hold title to certain real estate upon which Wayne Bank has foreclosed. WTRO did not hold title to any property as of December 31, 2009 and 2008. As of September 30, 2010, WTRO held title to one property which was carried in foreclosed real estate owned at a value of \$448,000.



Norwood Settlement Services, LLC, a Pennsylvania Limited Liability Company, was established in 2004 to provide title and settlement service to bank customers and non-customers. Gross revenues, included in other income, for 2009 totaled \$93,000 and \$83,000 in 2008.

#### Personnel

As of September 30, 2010, Wayne Bank had 112 full-time and 8 part-time employees. None of Wayne Bank's employees are represented by a collective bargaining group.

#### Properties

Wayne Bank operates from its main office located at 717 Main Street, Honesdale, Pennsylvania and ten additional branch offices. Wayne Bank's total investment in office property and equipment is \$14.1 million with a net book value of \$5.0 million as of September 30, 2010. Wayne Bank currently operates automated teller machines at all eleven of its facilities. Wayne Bank leases four of its locations with minimum lease commitments of \$3,347,000 through 2029. Three of the locations have various renewal options.

#### Legal Proceedings

Neither Norwood nor its subsidiaries are involved in any pending legal proceedings, other than routine legal matters occurring in the ordinary course of business, which in the aggregate involve amounts which are believed by management to be immaterial to the consolidated financial condition or results of operations of Norwood.

### NORWOOD MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis and related financial data are presented to assist in the understanding and evaluation of the financial condition and results of operations for Norwood and its subsidiary Wayne Bank as of September 30, 2010 and for the nine months ended September 30, 2010 and 2009 and as of December 31, 2009 and 2008 and for the years ended December 31, 2009, 2008, and 2007. This section should be read in conjunction with the consolidated financial statements and related footnotes included elsewhere in this proxy statement/prospectus.

#### Critical Accounting Policies

Note 2 to Norwood's consolidated financial statements lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of Norwood and its results of operations.

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

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

Restricted stock which represents required investment in the common stock of correspondent banks is carried at cost and as of September 30, 2010 and December 31, 2009, consists of the common stock of the Federal Home Loan Bank of Pittsburgh. In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of excess capital stock.

Management evaluates the restricted stock for impairment. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary decline in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB. Management believes no impairment charge is necessary related to the restricted stock as of September 30, 2010 and December 31, 2009.

In estimating other-than-temporary impairment losses on securities, Norwood considers 1) the length of time and extent to which the fair value has been less than cost 2) the financial condition of the issuer and 3) the intent and ability of Norwood to hold the security to allow for a recovery to fair value. During the fourth quarter of 2009, Norwood recorded an other-than-temporary impairment charge on two equity holdings totaling \$31,000. Norwood believes that the unrealized losses on all other securities at September 30, 2010 and December 31, 2009 represent temporary impairment of the securities, related to changes in interest rates.

#### Financial Condition

##### Changes in Financial Condition between September 30, 2010 and December 31, 2009

General. Total assets as of September 30, 2010 were \$534.6 million compared to \$529.7 million as of December 31, 2009 an increase of \$4.9 million. The increase was due primarily to a \$7.2 million increase in total deposits which was utilized to fund security purchases and also contributed to an increase in cash and cash equivalents.

Cash and Cash Equivalents. Cash and cash equivalents totaled \$19.8 million compared to \$17.4 million as of December 31, 2009, an increase of \$2.4 million. The increase in cash and cash equivalents was driven by an increase in deposits and proceeds from the sale and maturity of loans.

Securities. The fair value of securities available for sale as of September 30, 2010 was \$139.3 million compared to \$130.6 million as of December 31, 2009. Norwood purchased \$82.5 million of securities using the proceeds from \$76.0 million of securities sold, called, maturities and principal reductions as well as cash received from an increase in total deposits and from the sale of residential mortgage loans.

U.S. Government Agency securities decreased \$9.1 million to \$30.7 million due to sales and calls while obligations of States and political subdivisions increased \$16.6 million to \$48.9 million.



The carrying value of Norwood's securities portfolio (Available-for Sale and Held-to Maturity) consisted of the following:

	September 30, 2010		December 31, 2009	
	Amount	% of portfolio (dollars in thousands)	Amount	% of portfolio
US Government agencies	\$ 30,722	22.0%	\$ 39,772	30.3%
States and political subdivisions	48,915	35.1	32,343	24.6
Corporate securities	4,306	3.1	5,240	4.0
Mortgage-backed securities	54,789	39.3	53,154	40.5
Equity securities	745	0.5	776	0.6
Total	\$ 139,477	100.0%	\$ 131,285	100.0%

Norwood has securities in an unrealized loss position. In management's opinion, the unrealized losses in the mortgage-backed securities reflect changes in interest rates subsequent to the acquisition of specific securities. Norwood holds a small amount of equity securities in other financial institutions, the value of which has been impacted by the weakening conditions of the financial markets. During the fourth quarter of 2009, Norwood recorded an other-than-temporary impairment charge on two equity holdings totaling \$31,000. Management believes that all other unrealized losses represent temporary impairment of the securities as Norwood does not have the intent to sell these securities and it is more likely than not that it will not have to sell the securities before recovery of their cost basis.

Loans Receivable. Loans receivable totaled \$358.4 million at September 30, 2010 compared to \$363.5 million as of December 31, 2009. Residential real estate loans, including construction financing, decreased \$6.3 million due to the sale of \$10.5 million of residential mortgages and principal repayments. The loans were sold for interest rate risk management to shorten the average life of the mortgage loan portfolio and to reduce the risk to rising interest rates. Commercial loans including commercial real estate loans increased \$1.9 million during the period while all other loans decreased \$700,000.

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

	September 30, 2010		December 31, 2009	
	(dollars in thousands)			
Real Estate-Residential	\$ 126,745	35.3%	\$ 130,318	35.8%
Commercial	181,635	50.6	180,266	49.5
Construction	11,633	3.2	14,405	4.0
Commercial, financial and agricultural	24,645	6.9	24,116	6.6
Consumer loans to individuals	14,171	4.0	14,850	4.1
Total loans	358,829	100.0%	363,955	100.0%
Deferred fees (net)	(475)		(481)	
	358,354		363,474	
Allowance for loan losses	(5,513)		(5,453)	
Net loans receivable	\$ 352,841		\$ 358,021	





The allowance for loan losses totaled \$5,513,000 as of September 30, 2010 and represented 1.54% of total loans, compared to \$5,453,000 and 1.50% of total loans at year end, and \$4,663,000 or 1.30% of total loans, as of September 30, 2009. Norwood had net charge-offs for the nine months ended September 30, 2010 of \$670,000 compared to \$155,000 in the comparable period in 2009. The charge-offs during the nine months ended September 30, 2010 included \$607,000 of losses on loans that were previously carried in nonaccrual status. Norwood's loan review process assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes an analysis of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and a historical review of credit losses by loan type. Other factors considered include: concentration of credit in specific industries; economic and industry conditions; trends in delinquencies and loan classifications, large dollar exposures and loan growth. Management considers the allowance adequate at September 30, 2010 based on Norwood's criteria. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any, that might be incurred in the future.

As of September 30, 2010, non-performing loans totaled \$3,651,000, which is 1.02% of total loans. Included in the total are five commercial real estate loans for \$2.6 million; six consumer loans for \$762,000; one commercial loan for \$18,000 and three residential mortgage loans for \$281,000. At December 31, 2009, non-performing loans totaled \$5,015,000, or 1.38% of total loans. Included in this total were five commercial real estate loans for \$3.1 million; six consumer loans totaling \$996,000; two commercial loans for \$695,000 and three residential mortgage loans totaling \$87,000. The decrease was principally due to the resolution and payoff of two commercial credits.

Included in total non-performing loans as of September 30, 2010 were six loans in the amount of \$2.7 million which have been determined to be impaired in accordance with generally accepted accounting principles. A loan is considered impaired when, based upon current information and events, it is probable that all amounts due according to the contractual terms of the loan will not be collected. As of December 31, 2009, there were six loans totaling \$3.9 million in this category. Additionally, Norwood has determined that three other loan relationships totaling \$10.6 million were impaired as of September 30, 2010. These loans have not been transferred to nonaccrual status and therefore are not classified as non-performing. The three loans in question have been restructured and have made all payments under their modified terms. The subject loans have not been transferred to nonaccrual status since they have not been delinquent and do not meet the definition of nonaccrual loan as per Norwood's loan policy. As of December 31, 2009, there were two loans in this category totaling \$4.2 million. Details regarding the \$10.6 million of performing impaired loans as of September 30, 2010 are as follows:

- Two loans with a combined current balance of \$1,051,000 were granted to a food service corporation in December, 2003. The loan was considered impaired in September, 2009 due to a request for principal deferral by the borrower. As of September 30, 2010, the borrower is current with all payments under the modified terms of the loan. Improved cash flow is expected to result in the resumption of the original loan terms. No loss has been recognized to date on these loans.
- A loan with a current balance of \$3,047,000 was granted to a limited liability company in August, 2006 for the purpose of operating a hotel. In April 2009, the loan terms were modified and the loan was placed on impaired status in December, 2009 due to slow payment performance. The loan continues to perform under the modified terms. The loan will be monitored as to performance with a view toward removing it from the impaired category. No loss has been recognized to date on this loan.
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A loan with a current balance of \$6,500,000 was granted to a limited liability company in December, 2009 for the purpose of refinancing two prior commercial real estate loans. In

August, 2010, the loan was modified to allow the borrower time to recover from the current economic situation and the loan was classified impaired. Negotiations with the borrower are ongoing to reach a resolution to the credit. As of September 30, 2010, the borrower has made all payments under the modified terms and no loss has been recorded to date on this loan.

The following table sets forth information regarding non-performing loans and foreclosed real estate at the dates indicated:

	September 30, 2010	December 31, 2009
	(dollars in thousands)	
Loans accounted for on a non-accrual basis:		
Commercial and all other	\$ 18	\$ —
Real Estate-Commercial	2,590	3,833
Residential	281	1,083
Consumer	762	-
Total	3,651	4,916
Accruing loans which are contractually past due 90 days or more	—	99
Total non-performing loans	3,651	5,015
Foreclosed real estate	748	392
Total non-performing assets	\$ 4,399	\$ 5,407
Allowance for loans losses	\$ 5,513	\$ 5,453
Coverage of non-performing loans	1.51x	1.09x
Non-performing loans to total loans	1.02%	1.38%
Non-performing loans to total assets	0.68%	0.95%
Non-performing assets to total assets	0.82%	1.02%

Deposits. Total deposits as of September 30, 2010 were \$398.7 million compared to \$391.5 million as of December 31, 2009, an increase of \$7.2 million. During the period, interest bearing demand deposits, including money market deposits, increased \$23.3 million, savings deposits increased \$4.9 million and non-interest bearing demand balances increased \$6.5 million to offset a \$27.5 million reduction in certificates of deposit. The decrease in certificates includes \$15.5 million of certificates of deposit over \$100,000 due to the seasonality of municipal deposits and \$12.0 million of retail certificates due to the maturity of certificates which were generated through deposit promotions.

The following table sets forth deposit balances as of the dates indicated:

	September 30, 2010	December 31, 2009
	(dollars in thousands)	
Non-interest bearing demand	\$ 66,331	\$ 59,820
Interest bearing demand	39,438	34,410
Money market deposit accounts	78,336	60,035
Savings	49,283	44,423

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Time deposits <\$100,000	114,127	126,154
Time deposits >\$100,000	51,137	66,631
Total	\$ 398,652	\$ 391,473

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Borrowings. Short-term borrowings as of September 30, 2010 totaled \$24.5 million compared to \$25.8 million as of December 31, 2009. Securities sold under agreements to repurchase declined \$1.3 million principally due to the seasonality of municipal cash management accounts. Short-term borrowings consist of the following:

	September 30, 2010	December 31, 2009
	(dollars in thousands)	
Securities sold under agreements to repurchase	\$ 24,339	\$ 25,606
U.S. Treasury demand notes	191	197
	\$ 24,530	\$ 25,803

Other borrowings consisted of the following:

	September 30, 2010	December 31, 2009
	(dollars in thousands)	
Notes with the FHLB:		
Fixed rate note due September 2010 at 3.53%	\$ -	\$ 5,000
Convertible note due January 2011 at 5.24%	3,000	3,000
Convertible note due August 2011 at 2.69%	10,000	10,000
Fixed rate note due September 2011 at 4.06%	5,000	5,000
Convertible note due October 2012 at 4.37%	5,000	5,000
Convertible note due May 2013 at 3.015%	5,000	5,000
Convertible note due January 2017 at 4.71%	10,000	10,000
	\$ 38,000	\$ 43,000

The convertible notes contain an option which allows the FHLB, at quarterly intervals to change the note to an adjustable-rate advance at three month LIBOR plus 11 to 19 basis points. If the notes are converted, the option allows Wayne Bank to put the funds back to the FHLB at no charge.

#### Changes in Financial Condition between December 31, 2009 and December 31, 2008

Total Assets. Total assets as of December 31, 2009, were \$529.7 million compared to \$504.3 million as of year-end 2008, an increase of \$25.4 million or 5.0%. The increase in assets was driven by an increase in loans and cash and cash equivalents.

Loans Receivable. As of December 31, 2009, loans receivable totaled \$363.5 million compared to \$349.4 million as of year-end 2008, an increase of \$14.1 million, or 4.0%. Loan growth, principally in commercial real estate was partially offset by a lower level of home equity loans which is included in residential real estate and a net run-off in indirect automobile financing, which is included in consumer loans to individuals.

Residential real estate, which includes home equity lending, totaled \$130.3 million as of December 31, 2009, compared to \$133.4 million as of year-end 2008, a decrease of \$3.1 million. Norwood experienced a significant amount of residential mortgage refinancing activity in 2009 as customers took advantage of the low interest rate environment. Norwood does not originate any non-traditional mortgage products such as interest-only loans or option adjustable rate mortgages and has no sub-prime mortgage exposure. Norwood evaluates sales of its long-term fixed rate residential loan production for interest rate risk management, with \$21.7 million of 30 year fixed rate loans sold into the secondary market during 2009. In the current low interest rate environment, Norwood expects to continue selling mortgage loans in 2010. Norwood experienced a slow down and net decrease in home



equity lending in 2009. Total outstandings decreased \$6.5 million to \$47.2 million as of December 31, 2009. The decrease was due in part to consumers paying off home equity loans with proceeds from mortgage refinancing. The slow down in home equity lending is also indicative of lower real estate values.

Commercial loans consist principally of loans made to small businesses within Norwood's market and are usually secured by real estate or other assets of the borrower. Commercial real estate loans totaled \$180.3 million as of December 31, 2009, increasing from \$159.5 million as of December 31, 2008, an increase of \$20.8 million or 13.0%. The terms for commercial real estate loans are typically 15 to 20 years, with adjustable rates based on a spread to the prime rate or fixed for the initial three to five year period then adjusting to a spread to the prime rate. The majority of Norwood's commercial real estate portfolio is owner occupied and includes the personal guarantees of the principals. The growth in commercial real estate lending in 2009 was centered in loans to the hospitality lodging industry and summer camps all within Wayne Bank's primary market area. Commercial loans consisting principally of lines of credit and term loans secured by equipment or other assets decreased \$1.8 million to \$24.1 million as of December 31, 2008. The decrease was principally due to pay-offs in equipment loans and lower usage on lines of credit.

Norwood's indirect lending portfolio (included in consumer loans to individuals) declined \$1.6 million to \$8.4 million as of December 31, 2009. Norwood has de-emphasized indirect automobile lending and as a result of the soft economy has also experienced a general slow down in other indirect financing.

Allowance for Loan Losses and Non-Performing Assets. The allowance for loan losses totaled \$5,453,000 as of December 31, 2009 and represented 1.50% of total loans receivable compared to \$4,233,000 and 1.21% of total loans as of year end 2008. Net charge-offs for 2009 totaled \$465,000 and represented .14% of average loans compared to \$583,000 and 0.17% of average loans in 2008.

As of December 31, 2009, non-performing loans totaled \$5,015,000 and represented 1.38% of total loans compared to \$2,087,000 or .60% as of December 31, 2008. With the increase in non-performing loans, higher unemployment, soft real estate market and a slow economy Norwood increased the provision for loan losses to \$1,685,000 for the year ended December 31, 2009 compared to \$735,000 for 2008.

Norwood's loan review process assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes a review of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and an historical review of losses. Other factors considered in the analysis include; concentrations of credit in specific industries in the commercial portfolio; the local and regional economic condition; trends in delinquencies, internal risk rating classification, large dollar loans of over \$2 million and growth in the portfolio.

Norwood has limited exposure to higher-risk loans. There are no option ARM products, interest only loans, subprime loans or loans with initial teaser rates in its residential real estate portfolio. Wayne Bank has \$16.3 million of junior lien home equity loans. For 2009 net charge-offs for this portfolio totaled \$35,000.

As of December 31, 2009, Norwood considered its concentration of credit risk profile to be acceptable. The two highest concentrations are in the hospitality lodging industry and summer camps. In 2009 there were no losses in either portfolio and no delinquent loans at December 31, 2009.

Due to weaker economic conditions Norwood saw an increase in its internally adversely classified loans. Norwood assesses a loss factor against the classified loans, which is based on prior experience. Classified loans which are considered impaired are measured on a loan by loan basis. Norwood values such loans by either the present value of expected cash flows, the loans obtainable market price or the fair value of collateral if the loan is collateral dependent.

At December 31, 2009, the recorded investment in impaired loans, not requiring an allowance for loan losses was \$6,962,000 (net of charge-offs against the allowance for loan losses of \$154,000) and those impaired loans requiring an allowance totaled \$1,065,000 (net of a charge-off against the allowance for loan losses of \$480,000). The recorded investment in impaired loans not requiring allowance for loan losses was \$2,976,000 (net of \$360,000) and \$-0-requiring an allowance for loan losses as of December 31, 2008.

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

As of December 31, 2009, non-performing loans totaled \$5,015,000 and represented 1.38% of total loans increasing from \$2,087,000 and .60% of total loans as of December 31, 2008. The increase was principally due to one commercial real estate loan and a home equity loan in which Wayne Bank is in first lien position. Foreclosed real estate owned totaled \$392,000 as of December 31, 2009 and \$660,000 as of December 31, 2008. The decrease is principally due to a write-down on a property which consists of undeveloped residential building lots in Monroe County.

As a result of its analysis, after applying these factors, management considers the allowance as of December 31, 2009, adequate. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any that might be incurred in the future.



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

	Year ended December 31, (dollars in thousands)				
	2009	2008	2007	2006	2005
Allowance balance at beginning of period	\$ 4,233	\$ 4,081	\$ 3,828	\$ 3,669	\$ 3,448
Charge-offs:					
Commercial and all other	(17)	(7)	—	—	(4)
Real Estate	(358)	(465)	(4)	—	(6)
Consumer	(139)	(171)	(117)	(150)	(200)
Total	(514)	(643)	(121)	(150)	(210)
Recoveries:					
Commercial and all other	11	—	—	18	12
Real Estate	4	1	2	2	18
Consumer	34	59	54	65	46
Lease Financing	—	—	3	4	5
Total	49	60	59	89	81
Provision expense	1,685	735	315	220	350
Allowance balance at end of period	\$ 5,453	\$ 4,233	\$ 4,081	\$ 3,828	\$ 3,669
Allowance for loan losses as a percent of total loans outstanding	1.50%	1.21%	1.23%	1.21%	1.26%
Net loans charged off as a percent of average loans outstanding	0.13%	0.17%	0.02%	0.02%	0.05%
Allowance coverage of non-performing loans	1.1x	2.0x	25.0x	9.4x	10.4x

The following table sets forth information regarding non-performing assets.

	December 31, (dollars in thousands)				
	2009	2008	2007	2006	2005
Non-accrual loans:					
Commercial and all other	\$ —	\$ —	\$ —	\$ —	\$ —
Real estate	4,916	2,087	109	392	330
Consumer	—	—	2	17	11
Total	\$ 4,916	\$ 2,087	\$ 111	\$ 409	\$ 341
Accruing loans which are contractually past due 90 days or more	99	—	52	—	12
Total non-performing loans	5,015	2,087	163	409	353
Foreclosed real estate	392	660	—	—	—
Total non-performing assets	\$ 5,407	\$ 2,747	\$ 163	\$ 409	\$ 353

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Non-performing loans to total loans	1.38%	0.60%	0.05%	0.13%	0.12%
Non-performing loans to total assets	0.95%	0.41%	0.03%	0.09%	0.08%
Non-performing assets to total assets	1.02%	0.54%	0.03%	0.09%	0.08%

Securities. The securities portfolio consists principally of issues of United States Government agencies, including mortgage-backed securities, municipal obligations, and corporate debt. In accordance with generally accepted accounting principles in the United States, Norwood classifies its investments into two categories: held to maturity (HTM) and available for sale (AFS). Norwood does not have a trading account. Securities classified as HTM are those in which Norwood has the ability and the intent to hold the security until contractual maturity. As of December 31, 2009, the HTM portfolio totaled \$708,000 and consisted of two municipal obligations. Securities classified as AFS are eligible to be sold

due to liquidity needs or interest rate risk management. These securities are adjusted to and carried at their fair value with any unrealized gains or losses recorded net of deferred income taxes, as an adjustment to capital and reported in the equity section of the balance sheet as other comprehensive income (loss). As of December 31, 2009, \$130.6 million in securities were so classified and carried at their fair value, with unrealized appreciation; net of tax, of \$2,090,000, included in accumulated other comprehensive income as a component of stockholders' equity.

As of December 31, 2009, the average life of the portfolio was 2.6 years. Norwood has maintained a relatively short average life in the portfolio in order to generate cash flow to support loan growth and maintain liquidity levels. Purchases for the year totaled \$58.4 million with securities called, maturities and cash flow of \$44.1 million and proceeds from sales of \$15.4 million. The purchases were funded principally by cash flow from the portfolio. The carrying value of the securities portfolio is as follows:

	2009		2008	
	Carrying Value	(dollars in thousands) % of portfolio	Carrying Value	% of portfolio
US Government agencies	\$ 39,772	30.3%	\$ 35,813	27.5%
States & political subdivisions	32,343	24.6%	25,916	19.8%
Corporate Securities	5,240	4.0%	5,625	4.3%
Mortgage-backed securities	53,154	40.5%	62,318	47.5%
Equity securities	776	0.6%	1,155	0.9%
Total	\$ 131,285	100.0%	\$ 130,827	100.0%

The portfolio had \$19.5 million of adjustable rate instruments, principally adjustable rate mortgage backed securities as of December 31, 2009 compared to \$15.2 million at year end 2008. The portfolio contained no private label mortgage backed securities, collateralized debt obligations (CDOs), trust preferreds, structured notes, step-up bonds and no off-balance sheet derivatives were in use. The U.S. Government agency portfolio consists principally of callable notes with final maturities of generally less than five years. The mortgage backed securities are pass-through bonds with the Fannie Mae (FNMA), Freddie Mac (FHLMC), and Government National Mortgage Association (GNMA). Norwood has no exposure to common or preferred stock of FNMA or FHLMC.

Norwood evaluates the securities in its portfolio for other-than-temporary-impairment (OTTI) as fair value declines below cost. In estimating OTTI management considers (1) the length of time and the extent of the decline in fair value and (2) the financial condition and near-term prospects of the issuer. As of December 31, 2009 Norwood held 21 securities which had a combined unrealized loss of \$173,000. Management believes that these losses are principally due to changes in interest rates and represent temporary impairment as Norwood does not have the intent to sell these securities and it is more likely than not that it will not have to sell the securities before recovery of their cost basis. Norwood holds a small portfolio of equity securities of other financial institutions the value of which has been impacted by weakened conditions of the financial market. As a result, Norwood recorded an OTTI charge on two equity holdings totaling \$31,000.

#### Fair Value Of Financial Instruments

Norwood uses fair value measurements to record fair value adjustments to certain financial instruments and determine fair value disclosures. (see Note 16 of Notes to the Consolidated Financial Statements).



Approximately \$130.6 million, which represents 24.7% of total assets at December 31, 2009 consisted of financial instruments recorded at fair value on a recurring basis. This amount consists of entirely of Norwood's available for sale securities portfolio. Norwood uses valuation methodologies involving market-based or market derived information, collectively Level 1 and 2 measurements, to measure fair value. There were no transfers into or out of Level 3 for any instruments for the years ending December 31, 2009 and 2008.

Norwood utilizes a third party provider to perform valuations of the investments. Methods used to perform the valuations include: pricing models that vary based on asset class, available trade and bid information, actual transacted prices, and proprietary models for valuations of state and municipal obligations. In addition, Norwood has a sample of fixed-income securities valued by another independent source. Norwood does not adjust values received from its providers, unless it is evident that fair value measurement is not consistent with generally accepted accounting principles in the United States.

### Deposits

Norwood, through the eleven branches of Wayne Bank, provides a full range of deposit products to its retail and business customers. These products include interest-bearing and non-interest bearing transaction accounts, statement savings and money market accounts. Time deposits consist of certificates of deposit (CDs) with terms of up to five years and include Individual Retirement Accounts. Wayne Bank participates in the Jumbo CD (\$100,000 and over) markets with local municipalities and school districts, which are typically awarded on a competitive bid basis. Norwood has no brokered deposits.

Total deposits as of December 31, 2009, totaled \$391.5 million increasing \$31.9 million from \$359.6 million as of year-end 2008. The increase was principally due to a higher level of time deposits which increased by \$30.5 million.

Time deposits over \$100,000, which consist principally of school district funds, other public funds and short-term deposits from large commercial customers with maturities generally less than one year, totaled \$66.6 million as of December 31, 2009, compared to \$45.1 million at year-end 2008. The growth was principally due to a higher level of CDs with local school districts. These deposits are subject to competitive bid and Norwood bases its bid on current interest rates, loan demand, investment portfolio structure and the relative cost of other funding sources.

As of December 31, 2009, non-interest bearing demand deposits totaled \$59.8 million compared to \$56.8 million at year-end 2008. The increase is partially attributable to a higher level of commercial deposits, as a result of growth in the commercial loan portfolio. Cash management accounts in form of securities sold under agreements to repurchase included in short-term borrowings, totaled \$25.6 million at year end 2009 compared to \$23.4 million as of December 31, 2008. These balances represent commercial and municipal customers' funds invested in over-night securities. Norwood considers these accounts as a source of core funding.

### Comparison of Results of Operations for the Nine Months Ended September 30, 2010 and 2009

General. For the nine months ended September 30, 2010, net income totaled \$5,505,000 compared to \$5,261,000 earned in the similar period of 2009. Earnings per share for the current period were \$1.99 per share for both basic and diluted compared to \$1.92 per share basic and \$1.90 per share diluted for the nine months ended September 30, 2009. The resulting annualized return on average assets and annualized return on average equity for the nine months ended September 30, 2010 was 1.38% and 11.04% compared to 1.39% and 11.51%, respectively, for the similar period in 2009.



The following table sets forth changes in net income:

	Nine Months Ended September 30, 2010 to September 30, 2009 (dollars in thousands)	
Net income nine months ended September 30, 2009	\$	5,261
Change due to:		
Net interest income		466
Provision for loan losses		(145)
Gain on sales of loans, securities & deposits		(281)
Other income		(133)
Salaries and employee benefits		(24)
Occupancy, furniture and equipment expense, net		41
FDIC insurance assessment		260
Other real estate owned		116
All other expenses		(72)
Income tax expense		16
Net income nine months ended September 30, 2010	\$	5,505

**Net Interest Income.** Net interest income on a fully taxable equivalent basis (fte) for the nine months ended September 30, 2010 totaled \$15,461,000, an increase of \$624,000, or 4.2% over the similar period in 2009. The fte net interest spread and net interest margin were 3.72% and 4.05% respectively, compared to 3.64% and 4.08% respectively for the similar period in 2009.

Interest income (fte) totaled \$20,127,000 with a yield on average earning assets of 5.27% compared to \$20,668,000 and 5.68% for the similar period in 2009. The decrease in yield was due to a \$16.5 million increase in average interest bearing deposits with banks at an average yield of .29%. In addition, residential mortgage rates have declined causing a portion of the portfolio to refinance at lower rates. As a result, the fte yield on average loans in the current period was 6.02% down from 6.09% in the 2009 period. The yield on investment securities also declined 58 basis points reflecting the reinvestment of cash flow, maturities and calls at the current lower rate. Average earning assets totaled \$509.5 million for the nine months ended September 30, 2010 an increase of \$24.1 million over the similar period in 2009. The growth in average earning assets helped offset the decline in asset yields.

Interest expense for the nine months ended September 30, 2010 totaled \$4,666,000 with an average cost of 1.55% compared to \$5,831,000 and 2.03% for the 2009 period. Norwood reduced rates paid on its deposits by 52 basis points and short-term borrowings by 68 basis points. The cost of time deposits which is the largest component of interest expense was 2.08% for the 2010 period decreasing from 2.88% in 2009. This reflects time deposits maturing and repricing at the current lower rates.





Average Balance Sheet. The following table presents the average balances of Norwood's assets and liabilities for the nine months ended September 30, 2010 and 2009 and the resultant yields and rates thereon.

(Tax-Equivalent Basis,  
dollars in thousands)

	Nine Months Ended September 30,					
	2010			2009		
Average Balance	Average Interest	Average Rate	Average Balance	Average Interest	Average Rate	
(2)	(1)	(3)	(2)	(1)	(3)	(3)
<b>Assets</b>						
<b>Interest-earning assets:</b>						
Federal funds sold	\$ 3,000	\$ 7	0.31%	\$ 1,712	\$ 8	0.62%
Interest bearing deposits with banks	16,712	36	0.29	165	—	—
Securities held-to-maturity(1)	317	20	8.41	707	46	8.68
<b>Securities available for sale:</b>						
Taxable	96,307	2,372	3.28	99,786	3,164	4.23
Tax-exempt(1)	37,821	1,655	5.83	28,298	1,237	5.83
Total securities available for sale (1)	134,128	4,027	4.00	128,084	4,401	4.58
Loans receivable (4)	355,368	16,037	6.02	354,775	16,213	6.09
(5) Total interest earning assets	509,525	20,127	5.27	485,443	20,668	5.68
<b>Non-interest earning assets:</b>						
Cash and due from banks	7,235			9,024		
Allowance for loan losses	(5,445)			(4,477)		
Other assets	22,190			17,422		
Total non-interest earning assets	23,980			21,969		
Total Assets	\$ 533,505			\$ 507,412		
<b>Liabilities and Stockholders' Equity</b>						
<b>Interest bearing liabilities:</b>						
<b>Interest bearing demand and money</b>						
market	\$ 106,993	449	0.56	\$ 99,520	571	0.77
Savings	48,260	84	0.23	44,822	125	0.37
Time	179,546	2,799	2.08	169,260	3,658	2.88
Total interest bearing deposits	334,799	3,332	1.33	313,602	4,354	1.85
Short-term borrowings	23,790	87	0.49	26,039	229	1.17
Other borrowings	42,963	1,247	3.87	43,000	1,248	3.87

Total interest bearing liabilities	401,552	4,666	1.55	382,641	5,831	2.03
Non-interest bearing liabilities:						
Demand deposits	61,819			58,870		
Other liabilities	5,012			4,770		
Total non-interest bearing liabilities	66,831			63,640		
Stockholders' equity	65,122			61,131		
Total Liabilities and Stockholders' Equity	\$ 533,505			\$ 507,412		
Net interest income (tax equivalent basis)		15,461	3.72%		14,837	3.64%
Tax-equivalent basis adjustment		(713)			(555)	
Net interest income	\$ 14,748			\$ 14,282		
Net interest margin (tax equivalent basis)			4.05%			4.08%

(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) Annualized

(4) Loan balances include non-accrual loans and are net of unearned income.

(5) 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. 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.

	Increase/(Decrease)		
	Nine Months Ended September 30, 2010 Compared to		
	Nine Months Ended September 30, 2009		
	Variance due to		
	Volume	Rate	Net
	(dollars in thousands)		
Interest earning assets:			
Federal funds sold	\$ 6	\$ (7)	\$ (1)
Interest bearing deposits with banks	36	—	36
Securities held to maturity	(25)	(1)	(26)
Securities available for sale:			
Taxable	(107)	(685)	(792)
Tax-exempt securities	417	1	418
Total securities	310	(684)	(374)
Loans receivable	43	(219)	(176)
Total interest earning assets	370	(911)	(541)
Interest bearing liabilities:			
Interest-bearing demand and money market	63	(185)	(122)
Savings	14	(55)	(41)
Time	333	(1,192)	(859)
Total interest bearing deposits	410	(1,432)	(1,022)
Short-term borrowings	(18)	(124)	(142)
Other borrowings	(1)	0	(1)
Total interest bearing liabilities	391	(1,556)	(1,165)
Net interest income (tax-equivalent basis)	\$ (21)	\$ 645	\$ 624

Other Income. Other income totaled \$3,053,000 for the nine months ended September 30, 2010 compared to \$3,467,000 for the similar period in 2009. The current period includes \$208,000 in gains on sales of loans and servicing rights on the sale of \$10.5 million of residential mortgage loans compared to \$296,000 in similar gains on the sales of \$21.6 million of mortgage loans in the 2009 period. Gains on the sale investment securities totaled \$380,000 on sales of \$23.7 million for the 2010 period compared to \$423,000 of gains on sales of \$13.6 million in the similar 2009 period. The proceeds from investment securities sales were reinvested to maintain a fully invested position. Norwood also had a gain of \$150,000 on the sale of deposits related to a branch closure in 2009 period.

Provision for Loan Losses. Norwood's loan review process assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes a review of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and an historical review of losses. Other factors considered in the analysis include; concentrations of credit in specific industries in the commercial portfolio; the local and regional economic condition; trends in delinquencies, internal risk rating classification, large dollar loans of over \$2 million and growth in the portfolio. For the nine month period ending September 30, 2010, a provision of \$730,000 was added to the allowance for loan losses. Management has determined that the allowance was adequate as of the reporting date. During the nine months ended September 30, 2009, a provision of \$585,000 was added to the allowance.



**Other Expenses.** Other expense totaled \$9,448,000 for the nine months ended September 30, 2010 a decrease of \$321,000 compared to \$9,769,000 for the similar period in 2009. Higher FDIC insurance assessments, including a \$225,000 special assessment was included in the 2009 costs. The efficiency ratio for the 2010 period was 50.4% compared to 52.3% in the 2009 period.

**Income Tax Expense.** Income tax expense totaled \$2,118,000 for an effective tax rate of 27.8% in the 2010 period compared to \$2,134,000 and 28.9% in 2009. The decrease in the effective tax rate was principally due to a higher level of tax-exempt income related to purchases of municipal obligations held in the available-for-sale portfolio.

#### Comparison of Results of Operations for the years ended December 31, 2009, 2008 and 2007

**Summary.** Net income for Norwood for the year ended December 31, 2009 totaled \$7,063,000, an increase of \$386,000 or 5.8% over the \$6,677,000 earned in 2008. The resulting basic and diluted earnings per share were \$2.57 and \$2.55, respectively, increasing from \$2.44 and \$2.41 respectively in 2008. The return on average assets (ROA) for the year ended December 31, 2009 was 1.38% with a return on average equity (ROE) of 11.40% compared to an ROA of 1.36% and an ROE of 11.79% for the prior year. The increase in earnings was attributable to an increase in net interest income on a fully taxable equivalent basis (fte) of \$842,000 and \$816,000 of tax-exempt proceeds from a bank-owned life insurance (BOLI) policy which is \$1,371,000 net of tax. This was partially offset by a \$950,000 increase in the provision for loan losses and \$620,000 in higher FDIC insurance assessments, the net of which is \$1,036,000 after tax.

Net interest income on a fully taxable equivalent basis (fte) totaled \$19,872,000 in 2009, an increase of \$842,000 as compared to the prior year. Net interest income was favorably impacted by a \$25.1 million increase in average earning assets for 2009 compared to average earning assets in 2008. The net interest margin decreased 4 basis points to 4.03% for 2009. The decrease in margin was due to the low interest rate environment in 2009 with an average prime rate of 3.25% and federal funds rate of .25% compared to 5.09% and 1.84%, respectively in 2008. As a result, the yield on earning assets (fte) for 2009 was 5.60% compared to 6.14% in 2008. This impact on the yield on earning assets was partially offset by a 63 basis point decrease in the cost of interest-bearing liabilities.

Loans receivable increased \$14.1 million or 4.0% from the prior year-end. The increase in loans was centered in commercial real estate. Norwood experienced a significant volume of residential mortgage refinancing activity in 2009. During the year, Norwood sold \$21.7 million of fixed rate residential mortgages for purposes of interest rate risk management. As a result of the general slow down in the local economy, higher unemployment and a softer real estate market, Norwood did experience an increase in non-performing loans in 2009. As of December 31, 2009, total non-performing loans were \$5,015,000 and represented 1.38% of total loans compared to \$2,087,000 or .60% as of December 31, 2008. The increase was principally due to one commercial real estate loan and a home equity loan in which Wayne Bank is in a first lien position. For the year ended December 31, 2009, net charge-offs totaled \$465,000 compared to \$583,000 in 2008. With the increase in non-performing loans, higher unemployment, soft real estate market and slow economy, Norwood increased its provision for loan losses to \$1,685,000 for the year 2009 compared to \$735,000 for the year 2008. As of December 31, 2009, the allowance for loan losses totaled \$5,453,000 and 1.50% of total loans increasing from \$4,233,000 and 1.21% of loans at December 31, 2008.

Other income for 2009 totaled \$5,392,000 compared to \$4,087,000 in 2008, an increase of \$1,305,000. The earnings and proceeds on bank owned life insurance policies totaled \$1,196,000 in 2009 compared to \$344,000 in 2008. Gains on the sales of investment securities totaled \$463,000 on sales of



\$15.4 million for the 2009 period compared to \$18,000 in losses in the 2008 period. Norwood also had a \$150,000 gain on the sale of deposits related to a branch closure in the 2009 period. The 2009 period includes \$481,000 in gains on the sales of \$21.6 million of mortgage loans and servicing rights compared to \$499,000 in similar gains on sales of \$14.4 million of mortgage loans and servicing rights in the 2008 period.

For the year ended December 31, 2009, other expense totaled \$13,471,000 compared to \$12,240,000 for the similar period in 2009, an increase of \$1,231,000. The increase was due in part to higher FDIC insurance assessments which increased \$620,000 including the special assessment of \$225,000. This was partially offset by a lower level of foreclosed real estate costs which totaled \$436,000 in the 2009 period and \$582,000 in 2008. Income tax expense for the year 2009 totaled \$2,282,000 for an effective tax rate of 24.4% compared to \$2,836,000 of federal income tax expense and an effective tax rate of 29.8% for the prior year. The reduction in the effective tax rate is principally due to the receipt of \$816,000 in tax exempt BOLI proceeds in 2009.

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

Net income 2008	\$	6,677
Net interest income		708
Provision for loan losses		(950)
Earnings and proceeds on BOLI		852
Net realized gains on sales of securities		481
Other income		(28)
Salaries and employee benefits		(783)
FDIC insurance assessments		(620)
Other expenses		172
Income tax expense		554
Net income for 2009	\$	7,063

Net income for Norwood for the year-ended December 31, 2008 totaled \$6,677,000, an increase of \$166,000, or 2.6% over the \$6,511,000 earned in 2007. Basic and diluted earnings per share were \$2.44 and \$2.41, respectively, increasing from \$2.34 and \$2.30, respectively in 2007. The return on average assets (ROA) for the year ended December 31, 2008 was 1.36% with a return on average equity (ROE) of 11.79% compared to an ROA of 1.39% and ROE of 12.10% for the prior year. The increase in earnings was principally attributable to an increase in net interest income on a fully-taxable equivalent basis (fte) of \$1,219,000 which offset an increase in the provision for loan losses of \$420,000 and \$582,000 of write-down and costs to maintain a property in foreclosed real estate.

Net interest income (fte) totaled \$19,030,000 in 2008, an increase of \$1,219,000 or 6.8% over \$17,811,000 in the prior year. Net interest income was favorably impacted by a \$20.5 million increase in average earning assets for 2008 compared to average earning assets in 2007. The net interest margin increased 9 basis points to 4.07% in 2008. Norwood offset a 400 basis point decrease in prime rate of interest by managing its cost of funds. During 2008, the cost of interest-bearing liabilities declined 76 basis points to offset a 52 basis point drop in earning asset yields.

Loans receivable increased \$18.1 million or 5.5% from the prior year end. The increase in loans was centered in commercial real estate which increased \$25.8 million, which was partially offset by a lower level of construction financing and commercial term loans. As a result of the general economic slow down and a softer real estate market, Norwood did experience an increase in non-performing assets and net charge-offs in 2008. As of December 31, 2008, total non-performing assets were \$2,747,000 and represented .54% of total assets compared to \$163,000, or .03% as of December 31, 2007. The increase





was principally due to two credit facilities to one borrower, both of which have been written-down to their net realizable value. Net charge-offs for the year totaled \$583,000 compared to \$62,000 in 2007. Norwood increased its provision for loan losses to \$735,000 in 2008 compared to \$315,000 in 2007.

Other income for the year-ended December 31, 2008 totaled \$4,087,000 increasing \$563,000 from \$3,524,000 in the prior year. The increase was principally due to a \$499,000 gain on the sale of \$14.9 million of mortgage loans and servicing rights compared to \$23,000 in similar gains in 2007. For 2008, other expenses totaled \$12,240,000, an increase of \$899,000 or 7.9% over the prior year. The increase was principally due to a \$582,000 write-down to current realizable value of a foreclosed real estate property as well as costs to maintain the real estate. Excluding costs related to foreclosed real estate, other expenses increased 2.8%.

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

Net income 2007	\$ 6,511
Net interest income	1,129
Provision for loan losses	(420)
Gain on sale of mortgage loans and servicing rights	476
Other income	87
Salaries and employee benefits	(221)
Foreclosed real estate owned	(582)
Other expense	(96)
Income tax expense	(207)
Net income for 2008	\$ 6,677

**Net Interest Income.** Net interest income is the most significant source of revenue for Norwood and represented 78.0% of total revenue for the year ended December 31, 2009. Net interest income (fte) totaled \$19,872,000 for the year ended December 31, 2009 compared to \$19,030,000 for 2008, an increase of \$842,000 or 4.4%. The resulting fte net interest spread and net interest margin were 3.60% and 4.03% respectively in 2009 compared to 3.51% and 4.07%, respectively in 2008.

Interest income (fte) for the year ended December 31, 2009 totaled \$27,598,000 compared to \$28,724,000 for 2008. The fte yield on average earning assets for 2009 was 5.60%, decreasing 54 basis points from 6.14% in 2008. Interest income was unfavorably impacted by the significant decrease in short-term interest rates. During 2009, the prime interest rate averaged 3.25% compared to 5.09% during 2008. The Federal Funds rate and other short-term market rates showed a similar lower trend. This decline in short-term rates impacts Norwood's floating rate loans principally commercial real estate, lines of credit and home equity lines of credit which are based on a spread to the prime rate. As of December 31, 2009, \$58.1 million of loans were immediately replicable. The decrease in yield was partially offset by a \$25.1 million increase in average earning assets for the year 2009 compared to 2008.

Interest income (fte) earned on loans totaled \$21,688,000 for the year ended December 31, 2009 with a resulting fte yield of 6.09% compared to \$22,161,000 with an fte yield of 6.61% in 2008. The decrease was due to the lower prime interest rate in 2009, partially offset by growth of \$21.2 million in average loans. Norwood also established interest rate floors on lines of credit to offset the decrease in prime rate. The securities available-for-sale portfolio averaged \$129.4 million in 2009 with interest income (fte) of \$5,830,000 and a yield (fte) of 4.51% compared to \$130.9 million with interest income (fte) of \$6,473,000 and yield (fte) of 4.94% in 2008. The decrease in yield in 2009 was principally due to higher yielding investments maturing and reinvested at the current lower interest rates.



Federal Funds sold and interest-bearing deposits with banks averaged \$6.6 million at a yield of .29% compared to \$1.1 million at a yield of 2.53% in 2008. The increase in Fed Funds at the current low yield had a negative impact on the margin in 2009.

Interest expense for the year-ended December 31, 2009 totaled \$7,726,000 with an average cost of interest-bearing liabilities of 2.00% compared to interest expense of \$9,694,000 with an average cost of 2.63% in 2008. The decrease was principally due to a lower level of short-term interest rates. In the lower rate environment, Norwood reduced rates paid on money market accounts, time deposits and cash management accounts (included in short-term borrowings). The cost of time deposits decreased 101 basis points to 2.80% in 2009 from 3.81% in 2008, as higher costing time deposits matured and were replaced at lower rates. The rate on short-term borrowings principally cash management accounts declined 103 basis points to 1.11% in 2009 from 2.14% in 2008.

Net interest income represented 81.9% of total revenue for the year ended December 31, 2008. Net interest income (fte) totaled \$19,030,000 for the year ended December 31, 2008 compared to \$17,811,000 for 2007, an increase of \$1,219,000 or 6.8%. The resulting fte net interest spread and net interest margin were 3.51% and 4.07% respectively in 2008 compared to 3.27% and 3.98%, respectively in 2007.

Interest income (fte) for the year ended December 31, 2008 totaled \$28,724,000 compared to \$29,794,000 for 2007. The fte yield on average earning assets for 2008 was 6.14%, decreasing 52 basis points from 6.66% in 2007. Interest income was unfavorably impacted by the significant decrease in short-term interest rates. During 2008, the prime interest rate declined 400 basis points from 7.25% to 3.25%. This decline in short-term rates impacts Norwood's floating rate loans principally commercial real estate, lines of credit and home equity lines of credit. As of December 31, 2008, \$67.1 million of loans were immediately repricable. The decrease in yield was partially offset by a \$20.5 million increase in average earning assets for the year 2008 compared to 2007.

Interest income (fte) earned on loans totaled \$22,161,000 for the year ended December 31, 2008 with a resulting fte yield of 6.61% compared to \$23,876,000 with an fte yield of 7.38% in 2007. The decrease was due to the lower prime interest rate in 2008, partially offset by growth of \$11.7 million in average loans. The securities available-for-sale portfolio averaged \$130.9 million in 2008 with interest income (fte) of \$6,473,000 and a yield (fte) of 4.94% compared to \$118.7 million with interest income (fte) of \$5,623,000 and yield (fte) of 4.74% in 2007. The increase in yield in 2008 was partially due to higher yielding investments purchased in 2007 having a favorable impact in 2008.

Interest expense for the year-ended December 31, 2008 totaled \$9,694,000 with an average cost of interest-bearing liabilities of 2.63% compared to interest expense of \$11,983,000 with an average cost of 3.39% in 2007. The decrease was principally due to a lower level of short-term interest rates. In the lower rate environment, Norwood reduced rates paid on money market accounts and time deposits. The cost of time deposits decreased 76 basis points to 3.81% in 2008 from 4.57% in 2007, as higher costing time deposits matured and were replaced at lower rates. Norwood also utilized short-term borrowings to replace higher priced time deposits. Average short-term borrowings increased \$9.9 million to average \$32.3 million at an average cost of 2.14% in 2008 compared to \$22.4 million at an average cost of 4.15% in 2007.

Average Balance Sheet. The following table presents the average balances of Norwood's assets and liabilities for the year ended December 31, 2009, 2008 and 2007 and the resultant yields and rates thereon.

Year Ended December 31	2009			2008			2007		
	Average Balance (2)	Interest (1)	Ave Rate	Average Balance (2)	Interest (1)	Ave Rate	Average Balance (2)	Interest (1)	Ave Rate
(dollars in thousands)									
<b>ASSETS</b>									
Interest-earning assets:									
Federal funds sold	\$ 2,031	\$ 5	0.25%	\$ 1,082	\$ 28	2.59%	\$ 3,895	\$ 195	0.01%
Interest-bearing deposits with banks	4,552	14	0.31	66	1	1.52	483		26.38
Securities held-to-maturity	707	61	8.63	706	61	8.64	830		78.92
Securities available for sale:									
Taxable	100,120	4,131	4.13	108,809	5,207	4.79	99,399		4,574.60
Tax-exempt	29,283	1,699	5.80	22,108	1,266	5.73	19,320		1,052.45
Total securities available for sale	129,403	5,830	4.51	130,917	6,473	4.94	118,719		5,623.74
Loans receivable (3)(4)	356,345	21,688	6.09	335,137	22,161	6.61	323,444		23,876.38
Total interest-earning assets	493,038	27,598	5.60	467,908	28,724	6.14	447,371		29,796.66
Non-interest-earning assets:									
Cash and due from banks	6,935			8,102			8,128		
Allowance for loan losses	(4,539)			(4,013)			(3,925)		
Other assets	17,309			17,687			17,318		
Total non-interest-earning assets	19,705			21,776			21,521		
<b>TOTAL ASSETS</b>	<b>\$ 512,743</b>			<b>\$ 489,684</b>			<b>\$ 468,892</b>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>									
Interest-Bearing Liabilities:									
Interest-bearing demand and money market									
Savings	\$ 98,968	731	0.74	\$ 102,358	1,449	1.42	\$ 90,392		1,852.05
Time	44,526	158	0.35	44,510	208	0.47	45,858		216.47
Total interest-bearing deposits	174,201	4,876	2.80	160,462	6,116	3.81	172,986		7,900.57
Short-term borrowings	317,695	5,765	1.81	107,330	7,773	2.53	309,235		9,963.22
Other borrowings	26,233	292	1.11	32,328	693	2.14	22,443		932.15
	43,000	1,669	3.88	28,710	1,228	4.28	22,315		1,084.86

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Total interest-bearing liabilities	386,928	7,726	2.00	368,368	9,694	2.63	353,994	11,983.39
Non-interest-bearing liabilities:								
Non-interest-bearing demand deposits	59,224			59,759			56,523	
Other liabilities	4,615			4,908			4,545	
Total non-interest-bearing liabilities	63,839			64,667			61,068	
Stockholders' equity	61,976			56,649			53,830	
Total Liabilities and Stockholders' Equity	\$ 512,743			\$ 489,684			\$ 468,892	
Net Interest Income (tax equivalent basis)		19,872	3.60%		19,030	3.51%		17,813.27%
Tax-equivalent basis adjustment		(763)			(629)			(539)
Net Interest Income		\$ 19,109			\$ 18,401			\$ 17,272
Net interest margin (tax equivalent basis)			4.03%			4.07%		3.98%

1 Interest and yields are presented on a tax-equivalent basis using a marginal tax rate of 34%.

2 Average balances have been calculated based on daily balances.

3 Loan balances include non-accrual loans and are net of unearned income.

4 Loan yields include the effect of amortization of deferred fees net of costs.

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

(dollars in thousands)	Increase/(Decrease)					
	2009 compared to 2008			2008 compared to 2007		
	Volume	Rate	Net	Volume	Rate	Net
<b>INTEREST - EARNING ASSETS:</b>						
Federal funds sold	\$ 14	\$ (37)	\$ (23)	\$ (100)	\$ (67)	\$ (167)
Interest bearing deposits	14	(1)	13	(14)	(11)	(25)
Securities held to maturity	0	(0)	0	(11)	(2)	(13)
Securities available for sale:						
Taxable	(395)	(681)	(1,076)	445	191	636
Tax-exempt securities	416	17	433	158	56	214
Total securities available for sale	21	(664)	(643)	603	247	850
Loans receivable	1,353	(1,826)	(473)	840	(2,555)	(1,715)
Total interest earning assets	1,402	(2,528)	(1,126)	1,318	(2,388)	(1,070)
<b>INTEREST - BEARING LIABILITIES</b>						
Interest-bearing demand and money market	(47)	(671)	(718)	222	(625)	(403)
Savings	0	(50)	(50)	(6)	(1)	(7)
Time	490	(1,730)	(1,240)	(543)	(1,241)	(1,784)
Total interest-bearing deposits	443	(2,451)	(2,008)	(327)	(1,867)	(2,194)
Short-term borrowings	(113)	(288)	(401)	316	(555)	(239)
Other borrowings	564	(123)	441	284	(140)	144
Total interest bearing liabilities	894	(2,862)	(1,968)	273	(2,562)	(2,289)
<b>Net interest income (tax-equivalent basis)</b>	<b>\$ 508</b>	<b>\$ 334</b>	<b>\$ 842</b>	<b>\$ 1,045</b>	<b>\$ 174</b>	<b>\$ 1,219</b>

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

Other Income. Other income for the year-ended December 31, 2009 totaled \$5,392,000 compared to \$4,087,000 in 2008, an increase of \$1,305,000. The increase is partially due to the receipt of \$816,000 in proceeds from a death claim on a bank-owned life insurance policy. Norwood took advantage of the low interest rate environment and sold \$15.4 million of investment securities at a gain of \$463,000 compared to \$18,000 in losses in 2008. Norwood also had a \$150,000 gain on the sale of deposits related to a branch closure in the 2009 period. Service charges and fees decreased \$124,000 principally due to a lower volume of non-sufficient fund (NSF) fees. The decline in NSF fees was also related to a branch closure.

Other income totaled \$4,087,000 for the year-ended December 31, 2008 compared to \$3,524,000 in 2007. The increase was principally due to \$499,000 of gains on the sale of \$14.4 million of mortgage loans and servicing rights in 2008 compared to \$23,000 of similar gains in 2007. The loans were sold for interest-rate risk management purposes. Service charges and fees increased \$91,000 to \$2,600,000 principally due to a higher volume of NSF fees. Norwood offers title and settlement services through a subsidiary of Wayne Bank. Revenues (included in other)

totaled \$83,000 in 2008 compared to \$29,000 in 2007 principally due to a higher level of commercial real estate transactions. Norwood recorded a \$27,000 other-than-temporary-impairment charge on 1,000 shares of Wachovia Common stock in 2008. Norwood has no holdings of common or preferred stock of FNMA or FHLMC.

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

	2009	2008	2007
Service charges on deposit accounts	\$ 165	\$ 194	\$ 226
ATM Fees	273	280	241
NSF Fees	1,281	1,424	1,347
Gain on sale of deposits	150	—	—
Safe deposit box rental	52	55	55
Loan related service fees	390	281	236
Debit card	373	376	328
Fiduciary activities	354	404	423
Commissions on mutual funds & annuities	112	105	120
Gain on sales of mortgage loans and servicing rights	481	499	23
Earnings on and proceeds from bank-owned life insurance	1,196	344	333
Other income	102	143	175
	4,929	4,105	3,507
Net realized gains (losses) on sales of securities	463	(18)	17
Total	\$ 5,392	\$ 4,087	\$ 3,524

Other Expenses. Other expenses totaled \$13,471,000 compared to \$12,240,000 for 2008, an increase of \$1,231,000. Salaries and employee benefit costs increased \$783,000. The increase included \$267,000 related to a retirement plan which was funded by proceeds from a BOLI policy included in other income.

Norwood also paid out a portion of its post-retirement life insurance obligation, \$136,000, which was offset by a reduction to federal income tax. FDIC insurance assessments totaled \$710,000, an increase of \$620,000 over the prior year. The increase includes a special assessment of \$225,000 which was based on five basis points of assets less Tier 1 capital as of June 30, 2009. Instead of imposing additional special assessment, the FDIC required all banks to prepay their estimated risk-based assessment for the fourth quarter of 2009 and for all of 2010, 2011 and 2012 on December 30, 2009. Wayne Bank pre-paid \$1,711,000 which is included in other assets and will be amortized over 36 months. The efficiency ratio, which is total other expenses as a percentage of net interest income (fte) plus other income for the year ended December 31, 2009 was 53.3%.

Other expenses totaled \$12,240,000 for the year-ended December 31, 2008 compared to \$11,341,000 in 2007, an increase of \$899,000 or 7.9%. The increase was principally due to \$582,000 of costs associated with a parcel of foreclosed real estate. Excluding these costs, other expenses increased 2.8%.

Salaries and employee benefits expense which represented 49.4% of total other expenses increased \$221,000 or 3.8% to \$6,046,000 in 2008. Equipment expense decreased \$46,000 to \$507,000. The decline was principally due to lower maintenance expenses as Wayne Bank utilized branch document image capture technology which reduced back-office check processing costs. The same technology also reduced courier expense (included in other) by \$48,000. Data processing related costs totaled \$753,000, an increase of \$63,000 principally due to branch and remote deposit capture and enhancements to Wayne Bank's internet banking system. The efficiency ratio, which is total other expenses as a percentage of net interest income (fte) plus other income for the year ended December 31, 2008 was 52.9%.





In 2008, for 2009 the FDIC increased the assessment rate for most highly rated institutions to between 12 and 14 basis points for the first quarter of 2009 and to between 10 and 14 basis points thereafter. Assessment rates could be further increased if an institution's FHLB advances exceed 25% of deposits. The FDIC has also established a program under which it fully guarantees all non-interest bearing transaction accounts and senior unsecured debt of a bank or its holding company. Wayne Bank is participating in this program and will be assessed ten basis points for non-interest bearing transaction account balances in excess of \$250,000 and 75 basis points of the amount of any debt issued. Wayne Bank has no plans to issue any debt.

**Income Taxes.** Income tax expense for the year ended December 31, 2009 totaled \$2,282,000 for an effective tax rate of 24.4% compared to an expense of \$2,836,000 and an effective tax rate of 29.8% for 2008. The decrease in the effective tax rate is due to the receipt of \$816,000 in proceeds from a BOLI policy which is exempt from federal income taxes and a \$136,000 reduction to tax related to post-retirement life insurance benefits. Excluding these two items the effective tax rate for 2009 was 27.8%.

Income tax expense for the year ended December 31, 2008 totaled \$2,836,000 for an effective tax rate of 29.8% compared to an expense of \$2,629,000 and an effective tax rate of 28.8% for 2007.

#### Liquidity

Liquidity is the ability to fund customers' borrowing needs and their deposit withdrawal requests while supporting asset growth. Norwood's primary sources of liquidity include deposit generation, asset maturities, cash flow from payments on loans and securities and access to borrowing from the Federal Home Loan Bank and other correspondent banks.

As of September 30, 2010, Norwood had cash and cash equivalents of \$19.8 million in the form of cash, due from banks, Federal Funds sold and short-term deposits with other institutions. In addition, Norwood had total securities available for sale of \$139.3 million which could be used for liquidity needs. This totals \$159.1 million and represents 29.8% of total assets compared to \$147.9 million and 27.9% of total assets as of December 31, 2009. Norwood also monitors other liquidity measures, all of which were within Norwood's policy guidelines as of September 30, 2010 and December 31, 2009. Based upon these measures, Norwood believes its liquidity is adequate.

As of December 31, 2009, Norwood had cash and cash equivalents of \$17.4 million in the form of cash, due from banks, balances with the Federal Reserve Bank, short-term deposits with other institutions and Federal Funds sold. In addition, Norwood had total securities available for sale of \$130.6 million, which could be used for liquidity needs. This totals \$148.0 million and represents 27.9% of total assets compared to \$136.6 million and 27.1% of total assets as of December 31, 2008. Norwood also monitors other liquidity measures, all of which were within Norwood's policy guidelines as of December 31, 2009. Based upon these measures, Norwood believes its liquidity position is adequate.

Norwood maintains established lines of credit with the Federal Home Loan Bank of Pittsburgh (FHLB), the Atlantic Central Bankers Bank (ACBB) and other correspondent banks, which support liquidity needs. The total available under all the lines was \$39 million, with \$0- outstanding at December 31, 2009 and \$3.6 million outstanding at December 31, 2008. The maximum borrowing capacity from FHLB was \$197.6 million. As of December 31, 2009, Norwood had \$43 million in term borrowings from the FHLB.

## Capital Resources

Norwood has a line of credit commitment available from the Federal Home Loan Bank (FHLB) of Pittsburgh for borrowings of up to \$20,000,000 which expires in December 2011. There were no borrowings under this line at September 30, 2010 and December 31, 2009.

Norwood has a line of credit commitment from Atlantic Central Bankers Bank for \$7,000,000 which expires on June 30, 2011. There were no borrowings under this line as of September 30, 2010 and December 31, 2009.

Norwood has a line of credit commitment available which has no stated expiration date from PNC for \$16,000,000. Borrowings under this line were \$-0- as of September 30, 2010 and December 31, 2009.

Wayne Bank's maximum borrowing capacity with the FHLB was approximately \$183,000,000 as of September 30, 2010, of which \$38,000,000 was outstanding at September 30, 2010 and \$43,000,000 was outstanding at December 31, 2009. Advances from the FHLB are secured by qualifying assets of Wayne Bank.

As of September 30, 2010, stockholders' equity totaled \$68.4 million, compared to \$64.5 million as of December 31, 2009. The net change in stockholders' equity included \$5,505,000 in net income, that was partially offset by \$2,317,000 of dividends declared and a \$529,000 reduction due to an increase in Treasury Stock. In addition, accumulated other comprehensive income increased \$1,049,000 due to an increase in fair value of securities in the available for sale portfolio, net of tax. This increase in fair value is the result of a change in interest rates, which may impact the value of the securities. Because of interest rate volatility, Norwood's accumulated other comprehensive income could materially fluctuate for each interim and year-end period.

A comparison of Norwood's regulatory capital ratios is as follows:

	September 30, 2010	December 31, 2009
Tier 1 Capital (To average assets)	12.18%	11.87%
Tier 1 Capital (To risk-weighted assets)	18.14%	16.97%
Total Capital (To risk-weighted assets)	19.45%	18.27%

The minimum capital requirements imposed by the FDIC on Wayne Bank for leverage, Tier 1 and Total Capital are 4%, 4% and 8%, respectively. Norwood has similar capital requirements imposed by the Board of Governors of the Federal Reserve System (FRB). Wayne Bank is also subject to more stringent Pennsylvania Department of Banking (PDB) guidelines. Wayne Bank's capital ratios do not differ significantly from Norwood's ratios. Although not adopted in regulation form, the PDB utilizes capital standards requiring a minimum of 6.5% leverage capital and 10% total capital. Norwood and Wayne Bank were in compliance with FRB, FDIC and PDB capital requirements as of September 30, 2010 and December 31, 2009.

Total stockholders' equity as of December 31, 2009, was \$64.5 million, compared to \$58.7 million as of year-end 2008. The increase was principally due to retention of earnings of \$4,057,000 after



cash dividends declared of \$3,006,000. Accumulated other comprehensive income increased \$811,000 due to an increase in the fair value of securities in Norwood's portfolio principally as a result of a change in interest rates. As of December 31, 2009 Norwood had a leverage capital ratio of 11.87%, Tier 1 risk-based capital of 16.97% and total risk-based capital of 18.27% compared to, 11.45%, 16.22% and 17.50%, respectively, in 2008. Due to its strong capital position, Norwood elected not to participate in the Treasury Department's TARP Capital Purchase Program.

The book value of a share of Norwood common stock was \$23.25 as of December 31, 2009 compared to \$21.45 as of December 31, 2008. As of year-end 2009, the stock price was \$28.59, compared to \$27.50 as of December 31, 2008.

#### Off-Balance Sheet Arrangements

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

Wayne Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. Wayne Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Commitments to grant loans totaled \$19.9 million as of September 30, 2010 compared to \$17.7 million as of December 31, 2009.

Norwood's financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist mainly of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. Unused commitments, as of December 31, 2009 totaled \$58.2 million. They consisted of \$17.7 million in commercial real estate, construction and land developments loans, \$14.9 million in home equity lines of credit, \$3.7 million in standby letters of credit and \$21.9 million in other unused commitments principally commercial lines of credit. Because these instruments have fixed maturity dates and because many of them will expire without being drawn upon, they do not represent any significant liquidity risk.

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

A summary of the contractual amount of Norwood's financial instrument commitments is as follows:

	September 30, 2010	December 31, 2009
	(in thousands)	
Commitments to grant loans	\$ 19,867	\$ 17,713
Unfunded commitments under lines of credit	30,992	36,809
Standby letters of credit	3,195	3,679
	\$ 54,054	\$ 58,201

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

#### Contractual Obligations

	December 31, 2009				
	Total	Less than 1 year	1-3 years	4-5 years	Over 5 years
Time deposits	\$ 192,785	\$ 139,111	\$ 39,326	\$ 14,348	\$ —
Long-term debt	43,000	5,000	23,000	5,000	10,000
Operating leases	3,347	246	523	527	2,051
	\$ 239,132	\$ 144,357	\$ 62,849	\$ 19,875	\$ 12,051

#### Market Risk

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

Net interest income, which is the primary source of Norwood's earnings, is impacted by changes in interest rates and the relationship of different interest rates. To manage the impact of the rate changes, the balance sheet must be structured so that repricing opportunities exist for both assets and liabilities at approximately the same time intervals. Norwood uses net interest simulation to assist in interest rate risk management. The process includes simulating various interest rate environments and their impact on net interest income. As of September 30, 2010, the level of net interest income at risk in a 200 basis points change in interest rates was within Norwood's policy limits. Norwood's policy allows for a decline of no more than 8% of net interest income for a  $\pm$  200 basis point shift in interest rates.

Imbalance in repricing opportunities at a given point in time reflects interest-sensitivity gaps measured as the difference between rate-sensitive assets (RSA) and rate-sensitive liabilities (RSL). 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.

As of September 30, 2010, Wayne Bank had a positive 90 day interest sensitivity gap of \$61.2 million or 11.5% of total assets, increasing from \$26.3 million or 5.0% of total assets as of December 31, 2009. The change was principally due to a \$12.1 million increase in loans repricing within 90 days combined with lower level of time deposits maturing in the 90 day time frame in the amount of \$35.7 million. A positive gap means that rate-sensitive assets are greater than rate-sensitive liabilities at the time interval. This would indicate that in a rising rate environment, the yield on interest-earning assets could increase faster than the cost of interest-bearing liabilities in the 90 day time frame. The repricing intervals are managed by ALCO strategies, including adjusting the average life of the investment portfolio, pricing of deposit liabilities to attract longer term time deposits, loan pricing to encourage variable rate products and evaluation of loan sales of long-term fixed rate mortgages.

At December 31, 2009, Wayne Bank had a positive 90 day interest sensitivity gap of \$26.3 million or 5.0% of total assets. A positive gap indicates that the balance sheet has a higher level of rate-sensitive assets (RSA) than rate-sensitive liabilities (RSL) at the specific time interval. This would



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

Norwood analyzes and measures the time periods in which RSA and RSL will mature or reprice in accordance with their contractual terms and assumptions. Management believes that the assumptions used are reasonable. The interest rate sensitivity of assets and liabilities could vary substantially if differing assumptions were used or if actual experience differs from the assumptions used in the analysis. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in differing degrees to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Interest rates may change at different rates changing the shape of the yield curve. The level of rates on the investment securities may also be affected by the spread relationship between different investments. This was evident in 2009 as the spread between certain asset classes were at historical highs in relation to treasuries due to market liquidity and credit concerns. 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. It should be noted that the operating results of Norwood are not subject to foreign currency exchange or commodity price risk.

The following table displays interest-sensitivity as of September 30, 2010 (in thousands).

	3 Months Or Less	3-12 Months	1-3 Years	Over 3 Years	Total
Federal funds sold and interest-bearing deposits	\$ 10,123	\$ —	\$ 250	\$ —	\$ 10,373
Securities	16,850	22,924	43,347	55,133	138,254
Loans Receivable	94,118	58,912	101,107	104,217	358,354
Total Rate Sensitive Assets (RSA)	\$ 121,091	\$ 81,836	\$ 144,704	\$ 159,350	\$ 506,981
Non-maturity interest-bearing deposits	\$ 26,946	\$ 29,567	\$ 78,776	\$ 31,768	\$ 167,057
Time Deposits	27,317	71,032	49,955	16,960	165,264
Other	5,672	26,311	20,546	10,000	62,529
Total Rate Sensitive Liabilities (RSL)	\$ 59,935	\$ 126,910	\$ 149,277	\$ 58,728	\$ 394,850
Interest sensitivity gap	\$ 61,156	\$ (45,074)	\$ (4,573)	\$ 100,622	\$ 112,131
Cumulative gap	61,156	16,082	11,509	112,131	
RSA/RSL-cumulative	202.0%	108.6%	103.4%	128.4%	
As of December 31, 2009					
Interest sensitivity gap	\$ 26,256	\$ (35,423)	\$ (20,986)	\$ 135,313	\$ 105,160
Cumulative gap	26,256	(9,167)	(30,153)	105,160	
RSA/RSL-cumulative	128.9%	95.5%	91.2%	126.3%	



Non-GAAP Financial Measures

This proxy statement/prospectus contains or references fully taxable-equivalent (fte) interest income and net interest income, which are non-GAAP financial measures. Interest income (fte) and net interest income (fte) are derived from GAAP interest income and net interest income using an assumed tax rate of 34%. We believe the presentation of interest income (fte) and net interest income (fte) ensures

comparability of interest income and net interest income arising from both taxable and tax-exempt sources and is consistent with industry practice. Net interest income (fte) is reconciled to GAAP net interest income on pages 121 and 127. Although Norwood believes that these non-GAAP financial measures enhance investors' understanding of our business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP measures.

## BUSINESS OF NORTH PENN

### Corporate History

North Penn, a Pennsylvania corporation, is the holding company for North Penn Bank. The principal activities of North Penn are ownership and supervision of North Penn Bank. North Penn Bank is a community-oriented full-service savings bank providing traditional financial services to consumers and businesses in Northeastern Pennsylvania, including the communities in Lackawanna, Luzerne, Wayne and Monroe counties, among others.

North Penn Bank offers commercial and consumer loans of all types, including real estate loans, residential mortgage loans, home equity loans and lines of credit, auto loans and other credit products. North Penn Bank's deposit services include business and individual demand and time deposit accounts, NOW accounts, money market accounts, Individual Retirement Accounts and holiday accounts. North Penn Bank provides a number of convenience-oriented services and products to its customers, including direct payroll and social security deposit services, bank-by-mail services, access to a national automated teller machine network, safe deposit boxes, night depository facilities, notary services and travelers checks. North Penn Bank also offers internet banking and electronic bill payment.

### Market Area

North Penn is headquartered in Scranton, Pennsylvania, which is located in Northeastern Pennsylvania. In addition to its main office in center city Scranton, North Penn Bank operates four branch offices, located in Scranton, Clarks Summit, Stroudsburg and Effort, Pennsylvania. North Penn Bank's primary market area includes Lackawanna and Monroe Counties, and to a lesser extent, certain areas of the adjoining counties.

### Competition

Banking is a very competitive business, with both large and small banks competing for the same customers. In addition, non-bank competitors, such as brokerage firms, credit unions, insurance companies and mortgage brokers, are offering customers loan and deposit services. Legislative, regulatory and technological changes in the financial services industry have created these new competitors, and will continue to do so in the future. Technological advances have lowered the barriers to enter new market areas, allowed banks to expand their geographic reach by providing services over the internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. Changes in federal law permit affiliation among banks, securities firms and insurance companies, which increases competition in the financial services industry.

### Personnel

As of December 31, 2010, North Penn Bank employed 36 full-time and 10 part-time employees. None of these employees are represented by a collective bargaining agent, and North Penn believes that it enjoys good relations with its personnel.



## Loan Portfolio

North Penn Bank's business of making loans is its primary source of income. Historically, the principal lending activity of North Penn Bank has been the origination of fixed and adjustable rate mortgage ("ARM") loans collateralized by one- to four-family residential properties located in its market area. North Penn also originates multifamily, commercial real estate, commercial, construction and consumer loans which typically have higher yields than traditional one- to four-family loans.

In recent years, North Penn Bank has increased its emphasis on commercial lending and has actively pursued small business accounts.

**Commercial Loans.** North Penn Bank's commercial lending consists primarily of real estate based loans, including commercial and residential real estate collateral, with conservative loan-to-value ratios and the ability to repay based on operating cash flow. North Penn Bank has continued developing the commercial business loan program. The purpose of this program is to increase North Penn Bank's interest rate sensitive assets, increase interest income and diversify both the loan portfolio and North Penn Bank's customer base. North Penn Bank has two experienced commercial lenders to help in this effort. The terms and conditions of each loan are tailored to the needs of the borrower and based on the financial strength of the project and any guarantors. In reaching a decision on whether to make a commercial real estate loan, North Penn Bank considers the net operating income of the property, the borrower's expertise and credit history and the value of the underlying property. Loan to value ratios are a very important consideration. Generally, however, commercial real estate loans originated by North Penn Bank will not exceed 80% of the appraised value or the purchase price of the property, whichever is less. North Penn Bank also makes commercial vehicle loans.

**Residential Mortgages.** North Penn Bank makes fixed and adjustable mortgages and home equity loans on owner occupied residential real estate. North Penn Bank offers fixed-rate mortgage loans with maturities up to 30 years and less than 20% down payment supplemented with private mortgage insurance. These loans are secured by one- to four-family residences that are located in its primary market area. All of the mortgages are underwritten to be eligible for resale in the secondary market.

Home equity loans are offered as both closed end loans and lines of credit. Closed end loans can be fixed rate or adjustable. Home equity lines of credit have adjustable rates. The underwriting standards utilized for home equity loans and equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan and the value of the collateral securing the loan. The combined (first and second mortgage liens) loan-to-value ratio for home equity loans and equity lines of credit is generally limited to 80%. These loans offer the consumer access to liquidity and lower interest rates, and interest payments may be tax deductible.

**Consumer Loans.** North Penn Bank offers secured consumer loans, including deposit secured loans, auto loans, and indirect auto loans made through new and used car dealers. North Penn Bank's procedures for underwriting consumer loans include an assessment of an applicant's credit history and the ability to meet existing obligations and payments on the proposed loan. Although an applicant's creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral security, if any, to the proposed loan amount.

The following table summarizes North Penn Bank's loan portfolio by type of loan on the dates indicated.



(Dollars in thousands)	At September 30, 2010		2009		At December 31, 2008		2007	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Commercial	\$ 2,943	2.42%	\$ 3,368	2.91%	\$ 1,796	1.67%	\$ 2,157	2.19%
Real estate mortgages	115,894	95.47%	108,943	93.89%	100,127	93.34%	88,878	90.31%
Consumer	2,526	2.08%	3,719	3.21%	5,353	4.99%	7,383	7.50%
Total gross loans	121,363	100.00%	116,030	100.00%	107,276	100.00%	98,418	100.00%
Less: allowance for loan losses	1,667		1,484		1,170		1,171	
Loans, net	\$ 119,696		\$ 114,546		\$ 106,106		\$ 97,247	

The following table sets forth the estimated maturity of North Penn Bank's loan portfolio as December 31, 2009. The table does not include prepayments or scheduled principal repayments.

(Dollars in thousands)	Within One Year	One-Five Years	Over Five Years	Total
Commercial	\$ 116	\$ 797	\$ 2,455	\$ 3,368
Real estate mortgages	6,483	3,307	99,152	108,942
Consumer	348	2,996	376	3,720
Total	\$ 6,947	\$ 7,100	\$ 101,983	\$ 116,030

The following table presents, as of December 31, 2009, the dollar amount of all loans due after December 31, 2010, and whether such loans have fixed or adjustable interest rates.

(Dollars in thousands)	Due After December 31, 2010		
	Fixed	Adjustable	Total
Commercial	\$ 3,252	\$ -	\$ 3,252
Real estate mortgages	47,685	54,774	102,459
Consumer	3,371	1	3,372
Total	\$ 54,424	\$ 54,775	\$ 109,083

**Risk Elements.** Risk elements in the loan portfolio include past due, non-accrual loans, other real estate owned and a concentration of loans to one type of borrower. North Penn Bank monitors the loan portfolio to reduce the risk of delinquent and problem credits. Underwriting standards, including, but not limited to, loan-to-value and debt-to-income ratios, are followed to limit credit risk in the portfolio. Loan review is conducted by an outside party that evaluates loan quality, including adherence to underwriting standards. The loan review report goes directly to North Penn Bank's board of directors for their evaluation. The Pennsylvania Department of Banking and the FDIC, as North Penn Bank's regulators, also review the loan portfolio as part of their review process.

#### Asset Quality

North Penn Bank manages asset quality and controls credit risk through diversification of the loan portfolio and the application of policies designed to foster sound underwriting and loan monitoring practices. North Penn Bank's senior officers are responsible for monitoring asset quality, establishing credit policies and procedures subject to approval by the Board of Directors, ensuring the policies and procedures are followed and adjusting policies as appropriate.

Non-performing assets include non-performing loans and foreclosed real estate held for sale. Non-performing loans consist of loans where the principal, interest, or both, is 90 or more days past due and loans that have been placed on non-accrual. Income recognition of interest is discontinued when, in the opinion of management, the payment of such interest becomes doubtful. A loan is generally classified as non-accrual when principal or interest has been in default for 90 days or more or because of deterioration in the financial condition of the borrower such that payment in full of principal or interest is not expected. Loans past due 90 days or more and still accruing interest are loans that are generally well secured and in the process of collection. When loans are placed on non-accrual, accruing interest is no longer posted to earnings. At December 31, 2009, North Penn Bank had \$1.8 million in non-accrual loans as compared with \$1.1 million at December 31, 2008. As of December 31, 2009, for purposes of accounting and reporting in accordance with FASB ASC 310-40 Receivables – Troubled Debt Restructuring by Creditors (SFAS 15), North Penn Bank had no significant troubled debt restructurings. As of December 31, 2009, for purposes of accounting and reporting in accordance with FASB ASC 310-10.35 Receivables – Subsequent Measurement (SFAS 114), North Penn Bank had \$1.8 million in “impaired” loans.

The following table presents information regarding non-accrual mortgage, consumer and other loans, and foreclosed real estate as of the date indicated:

(Dollars in Thousands)	At September 30,		At December 31,	
	2010	2009	2009	2008
Non-accrual commercial	\$	-	\$ 42	-
Non-accrual commercial mortgage		1,006	960	572
Non-accrual residential mortgage		817	768	500
Non-accrual consumer		23	4	35
Total non-performing loans		1,846	1,774	1,107
Foreclosed real estate		348	88	-
Total non-performing assets	\$	2,244	\$ 1,862	\$ 1,107

For the period ended December 31, 2009, North Penn Bank would have received an additional \$44,000 in interest income under the original terms of such loans.

#### Allowance for Loan Losses

North Penn Bank determines the provision for loan losses through a quarterly analysis of the loan portfolio. The allowance for loan losses is established through provisions for losses charged to earnings. Loan losses are charged against the allowance when management believes that the collection of principal is unlikely. Recoveries of loans previously charged-off are credited to the allowance when realized. The allowance for loan losses is the amount that North Penn Bank’s management has determined to be necessary to absorb probable incurred loan losses inherent in the existing portfolio. Management’s evaluations, which are subject to periodic review by North Penn Bank’s regulators, are made using a consistently applied methodology that takes into consideration such factors as North Penn’s past loan loss experience, changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and collateral values, and current economic conditions. Part of management’s review includes risk ratings of commercial loans, and the engagement of an external loan review of all loans over \$400,000, insider loans and delinquent loans. Modifications to the methodology used in the allowance for loan losses evaluation may be necessary in the future based on further deterioration in economic and real estate market conditions, new information obtained regarding known problem loans, regulatory guidelines and examinations, the identification of additional problem loans, and other factors.





North Penn Bank's management realizes that general economic trends greatly affect loan losses. The continued weakness in the real estate market has resulted in increased loan delinquencies, defaults and foreclosures, and North Penn Bank believes that these trends are likely to continue. Assurances cannot be made either (1) that further charges to the allowance account will not be significant in relation to the normal activity or (2) that further evaluation of the loan portfolio based on prevailing conditions may not require sizable additions to the allowance and charges to provision expense.

The following table sets forth the year-end balances of and changes in the allowance for loan losses, as well as certain related ratios, for the period indicated:

(Dollars in thousands)	September 30,		December 31,		2007
	2010	2009	2009	2008	
Balance at beginning of period	\$ 1,484	\$ 1,170	\$ 1,170	\$ 1,171	\$ 1,121
Charge-offs:					
Commercial	39	50	146	—	—
Real estate mortgages	113	—	—	3	—
Consumer	—	22	25	47	45
TOTAL	152	72	171	50	45
Recoveries:					
Commercial	—	—	—	—	—
Real estate mortgages	—	—	—	—	—
Consumer	1	10	10	18	9
TOTAL	1	10	10	18	9
Net charge-offs	151	63	161	32	36
Provision charged to operations	334	135	475	31	86
Balance at end of period	\$ 1,667	\$ 1,243	\$ 1,484	\$ 1,170	\$ 1,171
Average loans outstanding, December 31			\$ 109,740	\$ 101,543	\$ 96,567
Loan reserve ratios:					
Net loan charge-offs to average loans	0.12%		0.15%	0.03%	0.04%
Allowance as a percentage of total loans	1.37%	1.12%	1.28%	1.09%	1.19%

The following table sets forth the breakdown of the allowance for loan losses by loan category for the period indicated:

(Dollars in thousands)	September 30, 2010		2009		December 31, 2008		2007	
	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans
Construction and land development	\$ —	0.1%	\$ -	0.3%	\$ -	0.5%	\$ -	0.1%
Residential, 1-4 family	533	36.3%	476	40.9%	313	41.9%	310	46.3%
Residential, multi-family	—	0.7%	-	0.8%	-	1.1%	-	1.5%

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Commercial real estate	1,067	58.4%	963	51.9%	765	49.9%	749	42.4%
Commercial	—	2.4%	-	2.9%	-	1.7%	-	2.2%
Consumer	67	3.1%	45	3.2%	92	4.9%	112	7.5%
Total	\$ 1,667	100.00%	\$ 1,484	100.0%	\$ 1,170	100.0%	\$ 1,171	100.0%

## Securities

Securities, primarily U.S. government agency bonds, mortgage-backed, and municipal bonds, totaled \$19.4 million or 12.4% of total assets at December 31, 2009 as compared with \$20.3 million or 14.6% of assets at December 31, 2008. North Penn Bank's securities portfolio is used to assist North Penn Bank in liquidity, asset/liability management and earnings. Securities can be classified as securities "held-to-maturity" or "available-for-sale." Investment securities held-to-maturity are carried at cost adjusted for amortization of premiums and accretion of discounts. Securities available-for-sale may be sold in response to changes in market interest rates, changes in the security's prepayment risk, increases in loan demand, general liquidity needs and other similar factors. Available-for-sale securities are carried at fair market value with unrealized gains and losses, net of tax, being included in North Penn Bank's accumulated other comprehensive income account. At December 31, 2009, accumulated other comprehensive income, a component of shareholders' equity, was a loss of \$2,000 versus a loss of \$460,000 at December 31, 2008. North Penn Bank classifies all new bond purchases as available-for-sale.

The following tables summarize the composition of North Penn Bank's investment portfolio as of the date indicated.

(Dollars in thousands)	September 30, 2010	
	Available for Sale	
	Amortized Cost	Estimated Fair Value
U.S. Agency securities	\$ -	\$ -
Mortgage-backed securities	1,270	1,340
State & political subdivisions	7,559	7,999
Other bonds	4,490	4,798
Total debt securities	13,319	14,137
Equity securities	1,624	1,360
Total securities	\$ 14,943	\$ 15,497

(Dollars in thousands)	December 31, 2009	
	Available for Sale	
	Amortized Cost	Estimated Fair Value
U.S. Agency securities	\$ 1,500	\$ 1,518
Mortgage-backed securities	2,662	2,751
State & political subdivisions	8,719	8,855
Other bonds	4,969	5,090
Total debt securities	17,850	18,214
Equity securities	1,591	1,184
Total securities	\$ 19,441	\$ 19,398

	December 31, 2008	
	Available for Sale	
(Dollars in thousands)	Amortized Cost	Estimated Fair Value
U.S. Agency securities	\$ 3,000	\$ 3,016
Mortgage-backed securities	5,074	5,142
State & political subdivisions	8,529	8,211
Other bonds	3,017	2,866
Total debt securities	\$ 19,620	\$ 19,235
Equity securities	1,371	1,058
Total securities	\$ 20,991	\$ 20,293

	December 31, 2007	
	Available for Sale	
(Dollars in thousands)	Amortized Cost	Estimated Fair Value
U.S. Agency securities	\$ 385	\$ 385
Mortgage-backed securities	4,521	4,480
State & political subdivisions	7,026	7,061
Other bonds	500	500
Total debt securities	\$ 12,432	\$ 12,426
Equity securities	1,071	940
Total securities	\$ 13,503	\$ 13,366

The amortized cost and weighted average yield of North Penn Bank's investment securities at December 31, 2009, by contractual maturity, are reflected in the following table. Actual maturities will differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	At December 31, 2009				
(Dollars in thousands)	Due in 1 year or less	Due in 1–5 years	Due in 5–10 years	Due after 10 Years	Total
US Agency securities:					
Amortized cost	\$ 1,000	\$ 500	\$ —	\$ —	\$ 1,500
Weighted average yield	3.75%	0.79%	—%	—%	2.76%
State & political subdivisions					
Amortized cost	\$ 1,050	\$ 710	\$ 3,187	\$ 3,772	\$ 8,719
Weighted average yield (1)	4.15%	4.26%	3.94%	4.01%	4.02%
Mortgage-backed securities					
Amortized cost	\$ 1,146	\$ —	\$ 975	\$ 541	\$ 2,662
Weighted average yield	4.14%	—%	4.70%	4.81%	4.48%
Other bonds					
Amortized cost	\$ 494	\$ 3,445	\$ 1,030	—	\$ 4,969
Weighted average yield	2.97%	3.87%	6.88%	—%	4.40%
Total amortized cost	\$ 3,690	\$ 4,655	\$ 5,192	\$ 4,313	\$ 17,850
Total fair value	\$ 3,737	\$ 4,709	\$ 5,382	\$ 4,387	\$ 18,214
Weighted average yield	3.88%	3.55%	4.66%	4.11%	

(1) Yields on tax-exempt securities were adjusted to a tax-equivalent basis using a 34% rate.

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## Deposits

North Penn Bank's primary source of funds is retail deposit accounts held primarily by individuals and businesses within its market area. North Penn Bank offers a variety of deposit accounts with a range of interest rates and terms. North Penn Bank's deposits consist of interest bearing and non-interest bearing checking accounts, money market, savings and certificate of deposit accounts and also IRA accounts. North Penn Bank's customer relationship strategy focuses on relationship banking for retail and business customers to enhance their overall experience with North Penn Bank. Deposit activity is influenced by state and local economic activity, changes in interest rates, internal pricing decisions and competition. North Penn Bank uses traditional means of advertising our deposit products and generally do not solicit retail deposits from outside its market area. Deposits are primarily obtained from the areas surrounding North Penn Bank's branch locations.

The following table sets forth the distribution of average deposits by major category and the average rate paid in each year as applicable:

(Dollars in thousands)	Nine Months Ended		Years Ended December 31,					
	September 30,		2009		2008		2007	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Non-interest bearing								
demand deposits	\$ 7,644	0.00%	\$ 8,653	0.00%	\$ 7,433	0.00%	\$ 8,437	0.00%
Interest bearing								
demand deposits	12,072	0.94%	10,386	1.24%	10,533	1.76%	8,266	1.63%
Savings and money								
market deposits	51,306	1.18%	37,149	1.48%	37,524	2.19%	18,742	2.32%
Time deposits	57,499	2.24%	60,305	3.01%	42,545	3.90%	49,201	4.57%
Total deposits	\$ 128,521		\$ 116,493		\$ 98,035		\$ 84,646	

The following table is a summary of time deposits of \$100,000 or more by remaining maturities as of December 31, 2009:

(Dollars in thousands)	Amount	Percent
Three months or less	\$ 6,950	41.26 %
Three to six months	5,284	31.37
Six to twelve months	2,444	14.51
Over twelve months	2,166	12.86
Total	\$ 16,844	100.00 %

Total deposits were \$124.1 million at December 31, 2009 compared to total deposits of \$99.2 million at December 31, 2008 and total deposits of \$83.7 million at December 31, 2007.

## Short-Term Borrowings

North Penn Bank, as part of its operating strategy, utilizes advances from the FHLBank of Pittsburgh ("FHLB") as an alternative to retail deposits to fund its operations. North Penn Bank has a line-of-credit with FHLBank of Pittsburgh for short-term borrowings varying from one day to three years. Borrowings under this line of credit are secured by qualified assets in the form of a blanket lien. Interest paid on these short-term borrowings varies based on interest rate fluctuations. At December





31, 2009, North Penn Bank had not utilized this credit facility. At December 31, 2008, the line had a balance of \$7,648,000.

The following table sets forth information regarding FHLBank of Pittsburgh overnight advances during the years ended.

(Dollars in thousands)	September 30,		December 31,		2007
	2010	2009	2009	2008	
Maximum amount outstanding at any month end	\$ —	\$ 3,985	\$ 3,985	\$ 7,648	\$ 11,287
Average amount outstanding	\$ —	\$ 909	\$ 909	\$ 1,157	\$ 7,804
Weighted average interest rate	—%	1.08%	1.08%	1.72%	5.11%
Balance outstanding at end of period	\$ —	\$ —	\$ -	\$ 7,648	\$ 5,879
Weighted average interest rate at end of period	—%	—%	-%	0.59%	5.13%

### Properties

North Penn Bank currently conducts its business through its five full-service banking offices in Scranton, Stroudsburg, Clarks Summit and Effort, Pennsylvania. North Penn Bank owns all of its offices, except for Clarks Summit, which is subject to a renewable lease that expires in 2011. The net book value of the land, buildings, furniture, fixtures and equipment owned by North Penn was \$4.0 million as of September 30, 2010.

### Legal Proceedings

North Penn is periodically a party to or otherwise involved in legal proceedings arising in the normal course of business, such as claims to enforce liens, claims involving the making and servicing of real property loans, and other issues incident to our business. North Penn does not believe that there is any pending or threatened proceeding against it which, if determined adversely, would have a material effect on its business or financial position.

## NORTH PENN MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF NORTH PENN

### General

The following presents a review of North Penn's results of operations and financial condition. This information should be read in conjunction with its consolidated financial statements and the accompanying notes to financial statements included in this document. North Penn's consolidated earnings are derived primarily from the operations of North Penn Bank, and to a lesser degree its other subsidiaries

North Penn's earnings come primarily from net interest income, which is the difference between interest income on interest-earnings assets, primarily loans and investment securities, and interest expense on interest-bearing liabilities, primarily deposits and borrowings. Net interest income is also impacted by the loan loss provision, other income, and other expenses.

### Critical Accounting Matters

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires North Penn's management to make estimates and assumptions that affect the reported

amounts of assets and liabilities and disclosure of contingent assets and liabilities as the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the valuation of the deferred tax assets.

North Penn considers the allowance for loan losses to be a critical accounting policy. Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. North Penn's management reviews the level of the allowance on a quarterly basis, at a minimum, and establishes the provision for loan losses based on the composition of the loan portfolio, delinquency levels, loss experience, economic conditions, and other factors related to the collectability of the loan portfolio.

Although North Penn believes that it uses the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. In addition, regulatory authorities, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require North Penn to recognize adjustments to the allowance based on its judgments about information available to it at the time of examination.

North Penn Bank believes that the judgments used in establishing the allowance for loan losses are based on reliable present information. In assessing the sufficiency of the allowance for loan losses, management considers, among other things described above, how well prior estimates have related to actual experience. North Penn Bank has not found it necessary to call into question the reliability of judgments used in its calculation.

There are also no particular risk elements in the local economy that put a group or category of loans at increased risk, however, North Penn Bank is pursuing commercial loans secured primarily by real estate, which may bear a higher risk of loss. These factors could lead to higher levels of allowance in future periods.

The estimate of the allowance level is always subject to normal inherent risk associated with any loan portfolio and can change based on future events, not known or predictable.

North Penn uses the asset and liability method of accounting for deferred income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. North Penn's management exercises significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed continually as regulatory and business factors change. Management's recording of deferred tax assets and liabilities and the need for a valuation allowance is made based on information available to North Penn Bank at the time. In particular, management evaluates the recoverability of deferred tax assets based on the ability of North Penn Bank to generate future profits to utilize such benefits. Management employs budgeting and periodic reporting processes to continually monitor progress. These factors lower the inherent risk in the assumption of future profits. Historically, North Penn Bank has had sufficient profits for tax recovery.

Comparison of Financial Condition at September 30, 2010 and December 31, 2009

General. Total assets increased \$8.2 million, or 5.2%, from \$156.3 million at December 31, 2009 to \$164.5 million at September 30, 2010. Significant changes in asset totals from December 31, 2009 to September 30, 2010 included an increase in cash and cash equivalents of \$6.9 million, while net loans increased \$5.2 million. Total liabilities increased \$7.5 million or 5.5% to \$144.6 million at September 30, 2010 as compared to \$137.1 million at December 31, 2009 due to a \$12.5 million increase in total deposits. The increase in liabilities was partially offset by the repayment of a \$5.0 million Federal Home Loan Bank advance. The advance had a fixed rate coupon of 6.19%. Stockholders' equity increased \$638,000 or 3.3% to \$19.9 million at September 30, 2010 as compared with \$19.3 million at December 31, 2009. The primary reason for the increase in stockholders' equity was earnings for the period and an increase in accumulated other comprehensive income due to an increase in the market value of available for sale investment securities.

Assets. Net loans increased \$5.2 million or 4.5%, since December 31, 2009. Commercial real estate loans have increased \$10.6 million, from \$60.3 million at December 31, 2009 to \$70.9 million at September 30, 2010. Substantially all of North Penn's commercial real estate loans are secured by properties located in North Penn Bank's primary market area. Consumer loans decreased \$1.2 million from \$3.7 million at December 31, 2009 to \$2.5 million at September 30, 2010, as North Penn Bank has chosen not to aggressively pursue that segment of loans. Residential mortgage loans decreased \$3.4 million from December 31, 2009, primarily due to sale of \$2.9 million in residential mortgage loans.

Investment securities decreased \$3.9 million, or 20.1%, to \$15.5 million at September 30, 2010 from \$19.4 million at December 31, 2009. The intent is to maintain a level of investment securities that is sufficient to maintain pledging and collateralized borrowing requirements while also temporarily deploying excess liquidity.

Allowance for Loan Losses. The allowance for loan loss increased \$183,000 or 12.3% during the nine months ending September 30, 2010. For the nine month period ending September 30, 2010, there were charge-offs of \$152,000 and recoveries of \$1,000. Management assesses the adequacy of the allowance for loan losses based on evaluating known and inherent losses in the loan portfolio and upon management's continuing analysis of the factors underlying the quality of the loan portfolio. The ratio of North Penn Bank's allowance for loan losses to total loans was 1.37% at September 30, 2010 and 1.28% at December 31, 2009. North Penn Bank is continually monitoring credit quality so that it can respond quickly to any deterioration with action to include strong collection efforts and increased allowance for loan loss protection.

While North Penn's management believes that, based on information currently available, the allowance for loan losses is sufficient to cover losses inherent in its loan portfolio at this time, no assurance can be given that the level of the allowance for loan losses is sufficient to cover future possible loan losses incurred by North Penn Bank or that future adjustments to the allowance for loan losses will not be necessary if economic and other conditions differ substantially from the economic and other conditions used by management to determine the current level of the allowance for loan losses. Management may in the future increase the level of the allowance for loan losses as a percentage of total loans and non-performing loans in the event it increases the level of commercial or consumer lending as a percentage of its total loan portfolio. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require North Penn Bank to provide additions to the allowance based upon judgments different from management.

Non-Performing Assets. On loans where the collection of principal or interest payments is doubtful, the accrual of interest income ceases. On loans 90 days or more past due as to principal and



interest payments, North Penn's policy, with certain limited exceptions, is to discontinue accruing interest. On occasion, this action may be taken earlier if the financial condition of the borrower raises significant concern with regard to the borrower's ability to service the debt in accordance with the terms of the loan agreement. Interest income is not accrued on these loans until the borrowers' financial condition and payment record demonstrate an ability to service the debt. Real estate that is acquired as a result of foreclosure is classified as other real estate owned. Other real estate owned is recorded at the lower of cost or fair value less estimated selling costs. Costs associated with acquiring and improving a foreclosed property may be capitalized to the extent that the carrying value does not exceed fair value less estimated selling costs. Holding costs are charged to expense. Gains and losses on the sale of other real estate owned are credited or charged to operations, as incurred.

Non-performing loans totaled \$1.8 million at both September 30, 2010 and December 31, 2009. The ratio of non-performing loans to total loans was 1.52% and 1.53% at September 30, 2010 and December 31, 2009, respectively.

Liabilities. Total deposits increased \$12.5 million, or 10.1%, to \$136.5 million at September 30, 2010 from \$124.1 million at December 31, 2009. The primary reason for the increase is a reflection of North Penn Bank's attractive deposit products and the economic environment causing consumers to be conservative in their approach to investing. Time deposits decreased \$8.6 million or 13.1% to \$57.3 million at September 30, 2010 from \$65.9 million at December 31, 2009. The decrease in time deposits was offset by an increase in core deposits of \$21.1 million or 36.2% to \$79.2 million at September 30, 2010 from \$58.1 million at December 31, 2009. Core deposits consist of all deposits other than certificates of deposit. North Penn's management has attempted to lessen its dependency on more volatile and rate sensitive certificates of deposit and has focused more on growing core deposits. The increase in liabilities was partially offset by the repayment of a \$5.0 million FHLB advance. The advance had a fixed rate coupon of 6.19%.

Stockholders' Equity. Stockholders' equity increased \$638,000 or 3.3% to \$19.9 million at September 30, 2010 as compared with \$19.3 million at December 31, 2009. Net income for the period and improvement in accumulated other comprehensive loss were the primary reasons for the increase. The increase was partially offset by purchases of Treasury Stock and payment of cash dividends

## Results of Operations

### Comparison of the Nine Month Periods Ended September 30, 2010 and 2009

General. Net income for the nine months ended September 30, 2010 totaled \$825,000, an increase of \$458,000 or 125% as compared to a net income of \$367,000 for the same period in 2009. The primary reason for the increase was an increase in net interest income and control of non-interest expense. The increase in net income was partially offset by an increase in provision for loan loss.

Net Interest Income. Net interest income increased \$754,000 or 22.5%, to \$4.1 million for the nine months ended September 30, 2010 from \$3.3 million for the comparable 2009 period.

North Penn's interest income for the nine month period ended September 30, 2010 increased \$296,000 or 5.2% to \$6.0 million as compared with \$5.7 million for the same period in 2009. Increased volume of loans was the primary reason for the increase in interest income.

Total interest expense for the nine months ended September 30, 2010 was \$1.9 million, a decrease of \$458,000 or 19.3%, compared to \$2.4 million for the same period in 2009. The decrease in interest expense reflects North Penn's continued focus on improvements in deposit mix. This strategy



along with the repayment of the FHLB advance of \$5.0 million in July 2010, contributed almost entirely to the decline in interest expense for both periods.

**Provision for Loan Loss.** North Penn's provision for loan and lease losses is based on interrelated factors such as the composition of and risk in our loan portfolio, the level of non-accruing and delinquent loans and the related collateral, as well as economic considerations. The provision charged to current earnings was \$334,000 for the nine months ended September 30, 2010, a \$199,000 or 147.4% increase as compared to a provision for loan losses of \$135,000 for the nine months ended September 30, 2009. The increase for the period is primarily due to North Penn's increasing commercial portfolio deterioration of two related loans which materialized in July 2010.

**Non-Interest Income.** For the nine months ended September 30, 2010, non-interest income totaled \$401,000, an increase of \$69,000 or 20.8% compared to the same period in 2009. The increase in non-interest income for the nine months ended September 2010 compared to the same period in 2009 was primarily attributed to a pre-tax gains from the sale of mortgage loans. The increase in non-interest income for the nine months ending September 30, 2010 over the comparable 2009 period was partially offset by an other-than-temporary impairment charge on two equity securities of \$24,000 that occurred during the first quarter of 2010.

**Non-Interest Expense.** For the nine months ended September 30, 2010, non-interest expense totaled \$3.1 million, a \$91,000 or 3.0% increase over the same period in 2009.

The primary reason for the increase in non-interest expense was an increase in salary and employee benefits. Salary and employee benefits increased \$144,000 for the nine month period in 2010 over the same period in 2009. Occupancy and furniture expense, professional fees and all other expenses collectively decreased \$22,000 for the nine month period ending September 30, 2010 as compared with same period in 2009. FDIC insurance expense decreased \$31,000 for the nine month period ending September 30, 2010 as compared with same period in 2009.

**Income Taxes.** North Penn's income tax expense increased \$75,000 or 46.9% to \$235,000 for the nine months ended September 30, 2010 compared to \$160,000 for the same period in 2009. The primary reason for the increase was primarily due to higher levels of income before tax.

#### Liquidity and Capital Resources

North Penn Bank's primary sources of funds are deposits, principal and interest payments on loans, FHLB advances and proceeds from mortgage loan sales. While maturities and scheduled amortization of loans are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions, and competition. North Penn Bank's regulators require North Penn Bank to maintain sufficient liquidity to ensure its safe and sound operation.

North Penn Bank's cash and cash equivalents increased \$6.9 million for the nine months ended September 30, 2009. During that period, cash was primarily provided from earnings and customer deposits and primarily used to pay down borrowings, fund the loan portfolio, and invest in federal funds sold.

#### Comparison of Financial Condition at December 31, 2009 and December 31, 2008

**General.** North Penn's assets increased \$17.3 million, or 12.5% to \$156.3 million at December 31, 2009 compared to \$139.0 million at December 31, 2008. An increase in loans outstanding combined with an increase in cash and cash equivalents were the primary reasons for the growth in assets. Liabilities





increased \$17.4 million or 14.5% to \$137.1 million at December 31, 2009 as compared with \$119.7 million at December 31, 2008. The primary reason for the increase was an increase in deposits. Stockholders' equity remained essentially unchanged at \$19.3 million at both December 31, 2009 and 2008.

Assets. Cash and cash equivalents increased \$9.6 million or 423.8% to \$11.9 million at December 31, 2009 as compared to \$2.3 million at December 31, 2008. The primary reason for the increase in cash and cash equivalents was due to liquidity caused by the maturities of investments and increased deposits at December 31, 2009.

Gross loans, net of loans held for sale, increased \$8.4 million or 8.0% to \$114.5 million at December 31, 2009 as compared with \$106.1 million at December 31, 2008. Commercial mortgages increased \$6.7 million, or 12.6%, from \$53.4 million at December 31, 2008, to \$60.2 million at December 31, 2009. Commercial loans increased \$1.6 million or 87.8% to \$3.4 million at December 31, 2009 from \$1.8 million at December 31, 2008.

The residential mortgage portfolio increased \$2.2 million, or 4.9%, to \$48.4 million at December 31, 2009, from \$46.1 million at December 31, 2008. Consumer loans decreased \$1.6 million from \$5.4 million at December 31, 2008 to \$3.7 million at December 31, 2009.

The investment portfolio decreased \$895,000, or 4.4%, to \$19.4 million at December 31, 2009, from \$20.3 million at December 31, 2008. The decrease was primarily the result of declines in mortgage-backed securities portfolio of \$2.4 million or 46.5% and in the US Agency securities portfolio of \$1.5 million or 49.7%.

North Penn reviews investment debt securities on an ongoing basis for the presence of other than temporary impairment ("OTTI"). An impairment that is an "other-than-temporary-impairment" is a decline in the fair value of an investment below its amortized cost attributable to factors that indicate the decline will not be recovered over the anticipated holding period of the investment. Other-than-temporary-impairments result in reducing the security's carrying value by the amount of credit loss. The credit component of the other-than-temporary impairment loss is realized through the statement of income and the remainder of the loss remains in other comprehensive income. After the review, North Penn's management concluded that two securities were impaired. OTTI losses of \$38,000 on these securities were recognized during the fourth quarter 2009. In accordance, with FASB ASC 320, the impairment was deemed credit related and run entirely through the income statement.

Deposits. Total deposits increased \$24.9 million, or 25.1%, to \$124.1 million at December 31, 2009, from \$99.2 million at December 31, 2008. The increase reflects, in part, efforts to attract and maintain deposits to utilize as a primary source of funds to fuel growth in loans. Core deposits which consist of all deposits other than certificates of deposit, increased \$2.7 million or 4.8% to \$58.1 million at December 31, 2009 as compared with \$55.5 million at December 31, 2008. Time deposit products, which include certificates of deposit, increased \$22.2 million, or 50.8%, from \$43.7 million at December 31, 2008, to \$65.9 million at December 31, 2009. North Penn Bank has tried to lessen its dependency on more volatile and rate sensitive certificates of deposit and has focused more on growing core deposits, particularly non-interest-bearing deposits.

Borrowings. Borrowings were \$12.0 million at December 31, 2009, a \$7.6 million or 38.9% decrease over the \$19.6 million at December 31, 2008. As of December 31, 2009, North Penn Bank had two outstanding loans, a line of credit and a letter of credit with FHLBank of Pittsburgh. The line of credit is available up to \$15.0 million at an interest rate equal to the current overnight rate. This line is a source of liquidity which is used to fund loan demand when deposit volume is inadequate. North Penn Bank has

a long term note of \$7.0 million from the FHLBank of Pittsburgh at a rate of 4.34%, maturing July 13, 2015.

Equity. Stockholders' equity remained essentially unchanged at \$19.3 million at both December 31, 2009 and 2008. The increase in net income and improvement in accumulated other comprehensive loss were offset by purchases of Treasury Stock and payment of cash dividends. In 2008, a stock repurchase plan was approved and commenced whereby up to 10% of North Penn's common stock will be purchased in the open market. In addition, on April 28, 2009, the Board of Directors authorized completion of the 2008 Plan (29,657 shares) and the repurchase of up to 142,341 shares of North Penn's outstanding common stock, or 10% of outstanding shares. At December 31, 2009, Treasury Stock purchases totaled \$2.1 million, a \$1.3 million or 160.9% increase as compared with \$805,000 at December 31, 2008.

#### Comparison of Results of Operations for the Years Ended December 31, 2009 and 2008

General. For the year ended December 31, 2009, North Penn recorded net income of \$787,000 an increase of \$433,000 or 122.3% compared to net income of \$354,000 for December 31, 2008.

Net Interest Income. Net interest income increased \$169,000 or 3.9%, to \$4.5 million for the year ended December 31, 2009, compared to \$4.4 million for the year ended December 31, 2008. Interest income remained flat at \$7.7 million for both years. Interest expense decreased \$185,000, or 5.6%, to \$3.1 million at December 31, 2009 from \$3.3 million at December 31, 2008, due to lower interest rates in deposits and reduced utilization of overnight borrowing. Consequently, the interest rate spread on a full tax equivalent basis decreased to 2.95% for the year ended December 31, 2009, compared to 3.09% for 2008. The ratio of average interest-earning assets to average interest-bearing liabilities decreased from 120.32% for the year ended December 31, 2008, to 116.97% for the year ended December 31, 2009.

Interest Income. Total interest income was essentially unchanged at \$7.7 million for the years ending December 31, 2009 and 2008. Increased loan volume partially offset a 74 basis point decrease in full tax equivalent total earning asset yield. For the year ending December 31, 2009, average interest earning assets increased \$16.4 million or 13.1% to \$141.2 million as compared with \$124.9 million for the comparable period in 2008. The primary reason for the increase in average interest earning assets was growth in the average balance of loans. For the twelve months ending December 31, 2009, average mortgages and average commercial loans increased \$8.9 million or 9.5% and \$1.1 million or 83.8% respectively, over the same period in 2008.

Total loan income for the year ended December 31, 2009 was \$6.9 million, a \$63,000 or 0.9% increase over the comparable 2008 period.

For the twelve months ended December 31, 2009, total average investment securities decreased \$2.0 or 11.6% as compared to the same period in 2008. The primary reason for the decrease was that maturing investments were used to help fund growth in the lending portfolio.

Interest Expense. Interest expense for the year ended December 31, 2009 totaled \$3.1 million. This represents a decrease of \$185,000, or 5.6%, for the year compared to \$3.3 million in 2008. The primary reason for the increase was a 60 basis point decline in yield on interest bearing liabilities between the twelve months ended December 31, 2009 and 2008. The decline in yield partially offset growth in total interest bearing liabilities.

For the year ending December 31, 2009, average interest bearing liabilities increased \$17.0 million or 16.4% to \$120.7 million as compared with \$103.8 million for the comparable period in



2008. The primary reason for the growth in average interest bearing liabilities was the growth in average time deposits of \$17.8 million or 41.8% to \$60.3 million for the year ended December 31, 2009. This compares with \$42.5 million for the year ended December 31, 2008.

The FHLBank of Pittsburgh average advance balance decreased \$263,000, or 2.0%, to \$12.9 million at December 31, 2009 from \$13.2 million for the year ended December 31, 2008. The decrease was the result of reduced need for overnight borrowings due to growth of deposits.

The following table presents information regarding average balances of assets and liabilities, as well as the total dollar amounts of interest income and dividends from average interest-earning assets and interest expense on average interest-bearing liabilities and the resulting average yields and costs. The yields and costs for the periods indicated are derived by dividing annual income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of the below table, average balances have been calculated using the average of daily balances, and non-accrual loans are included in average balances; however, accrued interest income has been excluded from these loans.

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Average Balance, Interest Income and Expense, Average Yield and Rates

(Dollars in thousands)	Years Ended December 31,								
	2009			2008			2007		
	Average Balance	Interest Income/Expense	Average Interest Rate	Average Balance	Interest Income/Expense	Average Interest Rate	Average Balance	Interest Income/Expense	Average Interest Rate
<b>Interest Earning Assets:</b>									
<b>Loans:</b>									
Commercial	\$ 2,302	\$ 138	5.99%	\$ 1,188	\$ 95	8.00%	\$ 1,749	\$ 120	6.86%
Real estate mortgages	102,942	6,389	6.21%	94,058	6,248	6.64%	85,801	6,086	7.09%
Consumer	4,496	351	7.81%	6,297	479	7.61%	9,017	591	6.55%
Total loans	109,740	6,878	6.27%	101,543	6,822	6.72%	96,567	6,797	7.04%
<b>Investment securities:</b>									
<b>U . S . government securities</b>									
U . S . government securities	5,838	214	3.67%	6,383	252	3.95%	5,221	220	4.21%
Municipal securities (1)	8,622	475	5.51%	7,774	440	5.66%	7,017	435	6.20%
Other securities	3,891	197	5.06%	2,279	141	6.19%	497	18	3.62%
Equities	1,100	—	1.64%	999	42	4.10%	969	37	3.82%
Total securities	19,451	886	4.86%	17,435	875	5.02%	13,704	710	5.18%
Equity securities at cost	1,591	47	2.95%	827	42	5.08%	1,183	75	6.34%
Deposits in banks	2,887	1	0.03%	728	7	0.96%	530	18	3.40%
Fed funds sold	7,569	12	0.16%	4,325	95	2.20%	-	-	-%
Total interest earning assets	141,238	7,863	5.54%	124,858	7,841	6.28%	111,984	7,600	6.79%
<b>Non-interest earning assets:</b>									
Cash and due from banks	2,886			1,430			1,821		
Other assets	6,953			2,910			5,875		
Less: allowance for loan losses	(1,232)			(1,192)			(1,157)		
Total non-interest earning assets	8,607			3,148			6,539		
Total assets	\$ 149,845			\$ 128,006			\$ 118,523		
<b>Liabilities and stockholders' equity</b>									
<b>Interest bearing liabilities</b>									
<b>Deposits:</b>									
Interest bearing demand	10,386	129	1.24%	\$ 10,533	185	1.76%	\$ 8,266	135	1.63%
Savings and money market	37,149	551	1.48%	37,524	822	2.19%	18,742	434	2.32%
Time deposits	60,305	1,815	3.01%	42,545	1,661	3.90%	49,201	2,248	4.57%
Total interest bearing deposits	107,840	2,495	2.31%	90,602	2,668	2.94%	76,209	2,817	3.70%

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Other borrowings	12,909	631	4.89%	13,172	643	4.88%	19,761	1,043	5.28%
Total interest bearing liabilities	120,749	3,126	2.59%	103,774	3,311	3.19%	95,970	3,860	4.02%
Total non-interest bearing liabilities	9,598			9,099			10,441		
Total liabilities	130,347			112,873			106,411		
Stockholders' equity	19,498			15,133			12,112		
Total liabilities and stockholders' equity	\$ 149,845			\$ 128,006			\$ 118,523		
Net interest spread (1)			2.95%		\$ 4,530	3.09%		\$ 3,740	2.77%
Net interest margin (1)			3.33%			3.63%			3.34%
Taxable equivalent adjustment		\$ 149			\$ 150			\$ 148	
Average earning assets as a percentage of interest bearing liabilities			116.97%			120.32%			116.69%

(1) The yield on municipal securities is computed on a tax equivalent basis at the U.S. federal income tax rate of 34%.

North Penn's management believes that it is common practice in the banking industry to present interest income and related yield information on tax exempt securities on a tax-equivalent basis and that such information is useful to investors because it facilitates comparisons among financial institutions. However, the adjustment of interest income and yields on tax exempt securities to a tax equivalent amount may be considered to include non-GAAP financial information. A reconciliation to GAAP is provided below.

Tax Equivalent Reconciliation

	Years Ended December 31,					
	2009		2008		2007	
(Dollars in thousands)	Interest	Average Yield	Interest	Average Yield	Interest	Average Yield
Municipal securities – nontaxable	\$ 288	3.80%	\$ 290	3.73%	\$ 287	4.09%
Tax equivalent adjustment (1)	149	—	150	—	148	—
Municipal securities – tax equivalent	\$ 437	5.75%	\$ 440	5.66%	\$ 435	6.20%
Net interest income – nontaxable	\$ 4,549		\$ 4,380		\$ 3,592	
Tax equivalent adjustment (1)	149		150		148	
Net interest income – tax equivalent	\$ 4,698		\$ 4,530		\$ 3,740	
Interest rate spread – no tax adjustment		2.85%		2.97%		2.63%
Net interest margin – no tax adjustment		3.22%		3.51%		3.21%

(1) The tax equivalent adjustment is based on a tax rate of 34% for all periods presented.

Rate/Volume Analysis

(Dollars in thousands)	Year Ended December 31, 2009 Compared to 2008		
	Net	Volume	Increase (Decrease) Due to Rate
Interest Income:			
Loans	\$ 56	\$ 551	\$ (495)
Investment securities	10	101	(91)
Equity securities	5	39	(34)
Deposits in other banks	(5)	21	(26)
Fed funds sold	(83)	71	(154)
Total	\$ (17)	\$ 783	\$ (800)
Interest Expense:			
Interest bearing demand deposits	\$ (56)	\$ (3)	\$ (53)
Savings and money market deposits	(271)	(8)	(263)
Time deposits	154	693	(539)
Other borrowings	(12)	(13)	1



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Total	\$	(185)	\$	669	\$	(854)
Net Interest Income	\$	168	\$	114	\$	54

Changes in interest due to volume and rate have been allocated by reference to changes in the average balances and the average interest rates of interest earning assets and interest bearing liabilities.

## Interest Sensitivity Analysis

	At December 31, 2009 Maturing Or Repricing In:				Total
	Within 3 Months	4 – 12 Months	1 – 5 Years	Over 5 Years	
Interest earning assets:					
Interest bearing deposits	\$ 560	-	-	-	\$ 560
Investment securities	-	3,741	4,337	11,320	19,398
Loans	16,434	7,365	45,702	46,529	116,030
Total interest earning assets	\$ 16,994	\$ 11,106	\$ 50,039	\$ 57,849	\$ 135,988
Interest bearing liabilities:					
Interest bearing demand	\$ 7,916	-	-	-	\$ 7,916
Money market	7,598	-	-	-	7,598
Savings	-	-	-	33,838	33,838
Time deposits	24,758	28,830	12,330	-	65,918
Borrowed funds	-	5,000	-	7,000	12,000
Total interest bearing liabilities	\$ 40,272	\$ 33,830	\$ 12,330	\$ 40,838	\$ 124,270
Period Gap	\$ (23,278)	\$ (22,724)	\$ 37,709	\$ 17,011	
Cumulative gap	\$ (23,278)	\$ (46,002)	\$ (8,293)	\$ 8,718	
Ratio of cumulative gap to total assets	(14.89%)	(29.43%)	(5.30%)	5.58%	

## Assumptions:

\*Adjustable rate loans have been distributed among the categories by repricing dates.

\*Mortgage backed investments and loans do not take into account principal prepayments.

\*All transaction deposit accounts have been placed into the within three months category as they have no stated maturity and rates will adjust as market rates adjust.

\*All savings accounts have been placed in the beyond five years category based upon historical experience.

Earnings are dependent on maintaining adequate net interest yield or spread between rates earned on assets and the cost of interest bearing liabilities. North Penn Bank must manage its interest rate sensitivity to maintain adequate spread during rising and declining interest rate environments. Decisions about which bonds to purchase are based upon factors such as term, yield and asset quality. Short term bonds enhance rate sensitivity but typically have lower yields. North Penn Bank's investment strategy carries the majority of investments as maturing after the five year period illustrated above. All investments are held available for sale which gives us the flexibility to sell in response to market changes. The money can then be used to fund loan growth or reinvested in bonds at the new interest rate.

Having a similar amount of assets repricing, or maturing, at or about the same time as liabilities reprice or mature, reduces interest rate risk. However, management recognizes certain trends and historical experiences for some products. Accounts such as savings, interest checking, and money market accounts are core deposits and do not have the same reaction to interest rate changes as time deposits do. These accounts tend to change according to cash flow and the transaction needs of North Penn Bank's customers.

According to the table, North Penn Bank has a negative gap position, which means liabilities will reprice faster than assets. When interest rates are rising, this will tend to reduce interest spread and net interest income, and when rates are falling, interest spread and net income should increase.

Provisions for Loan Losses; Allowance for Loan Losses. For the year ending December 31, 2009, North Penn recorded a provision for loan loss in the amount of \$475,000, compared to \$31,000 for the year ended December 31, 2008. The increase in the provision expense reflects an increase in the

levels of delinquent loans and management's analysis of economic conditions in North Penn Bank's market areas. In addition, the increased provision reflects the strategy of growing the commercial portfolio. These loans have a higher risk of default and loss than single-family residential mortgage loans because repayment of the loans often depends on the successful operation of a business or the underlying property. The allowance for loan losses as a percent of total loans was 1.28% at December 31, 2009, compared to 1.09% at December 31, 2008.

The following table illustrates information related to North Penn Bank's nonperforming assets at the dates indicated. North Penn Bank had no troubled debt restructurings or accruing loans past due 90 or more days at the dates presented.

	At December 31,		% Change
	2009	2008	
(Dollars in thousands)			
Nonaccrual loans	\$ 1,774	\$ 1,107	60.3%
Other real estate owned	88	-	
Total nonperforming assets	\$ 1,862	\$ 1,107	68.2%
Total nonperforming loans to total loans	1.53%	1.03%	48.4%
Total nonperforming loans to total assets	1.13%	0.80%	41.8%
Total nonperforming assets to total assets	1.19%	0.80%	48.88%

**Non-Interest Income.** For the year ended December 31, 2009, non-interest income totaled \$404,000, a \$66,000 or 19.5% increase over the same period in 2008. The increase was primarily the result a \$56,000 or 58.9% increase in income on bank owned life insurance over the comparable period in 2008. The increase in non-interest income was partially offset by an other-than-temporary impairment charge on several equity securities of \$38,000 for the year ending December 31, 2009.

**Non-Interest Expense.** For the year ended December 31, 2009, non-interest expense decreased \$566,000 or 13.5% to \$3.6 million as compared to \$4.2 million for the year ending December 31, 2008. The primary reason for the decrease was the 2009 receipt of a net insurance settlement of \$468,000 stemming from the 2008 loss on accounting errors of \$475,000. Salaries and employee benefits increased \$79,000 or 3.9% to \$2.1 million for the year ended December 31, 2009 as compared with the same period in 2008. The primary reason for the increase was increased benefit costs and merit increases for staff. For the year ended December 31, 2009, FDIC insurance was \$240,000 as compared to \$14,000 for the same period in 2008. The increase in the FDIC assessment for the year ended December 31, 2009 was attributable to the expiration of credits during 2008, an increase in the assessment rate for 2009 and an FDIC-imposed industry-wide 5 basis point special assessment totaling \$67,000.

**Income Taxes.** North Penn Bank recorded income tax expense for the year ended December 31, 2009 of \$85,000, compared to an income tax expense of \$153,000 for the year ended December 31, 2008.

## SUPERVISION AND REGULATION

Set forth below is a brief description of certain laws which relate to the regulation of the Norwood and North Penn and Wayne Bank and North Penn Bank. The description does not purport to be complete and is qualified in its entirety by

reference to applicable laws and regulations.

#### Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was signed into law. The Dodd-Frank Act is intended to effect a fundamental restructuring of federal banking regulation. Among other things, the Dodd-Frank Act creates a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. The Dodd-Frank Act additionally creates a new independent federal regulator to administer federal consumer protection laws. The Dodd-Frank Act is expected to have a significant impact on our business operations as its provisions take effect. Among the provisions that may affect us are the following:

**Holding Company Capital Requirements.** The Dodd-Frank Act requires the Federal Reserve to apply consolidated capital requirements to depository institution holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by a bank holding company with less than \$15 billion in assets. The Dodd-Frank Act additionally requires capital requirements to be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

**Deposit Insurance.** The Dodd-Frank Act permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2009, and extends unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012. The Dodd-Frank Act also broadens the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Effective one year from the date of enactment, the Dodd-Frank Act eliminates the federal statutory prohibition against the payment of interest on business checking accounts.

**Corporate Governance.** The Dodd-Frank Act will require publicly traded companies to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called “golden parachute” payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders. The new legislation also authorizes the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company’s proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of \$1.0 billion, regardless of whether the company is publicly traded or not. The Dodd-Frank Act gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

**Prohibition Against Charter Conversions of Troubled Institutions.** Effective one year after enactment, the Dodd-Frank Act prohibits a depository institution from converting from a state to federal charter or vice versa while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of the conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days. The notice must include a plan to address the significant supervisory matter. The converting institution must also file a copy of the



conversion application with its current federal regulator which must notify the resulting federal regulator of any ongoing supervisory or investigative proceedings that are likely to result in an enforcement action and provide access to all supervisory and investigative information relating hereto.

**Interstate Branching.** The Dodd-Frank Act authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks will be able to enter new markets more freely.

**Limits on Derivatives.** Effective 18 months after enactment, the Dodd-Frank Act prohibits state-chartered banks from engaging in derivatives transactions unless the loans to one borrower limits of the state in which the bank is chartered takes into consideration credit exposure to derivatives transactions. For this purpose, derivative transaction includes any contract, agreement, swap, warrant, note or option that is based in whole or in part on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities securities, currencies, interest or other rates, indices or other assets.

**Transactions with Affiliates and Insiders.** Effective one year from the date of enactment, the Dodd-Frank Act expands the definition of affiliate for purposes of quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or its affiliates. The Dodd-Frank Act will apply Section 23A and Section 22(h) of the Federal Reserve Act (governing transactions with insiders) to derivative transactions, repurchase agreements and securities lending and borrowing transaction that create credit exposure to an affiliate or an insider. Any such transactions with affiliates must be fully secured. The current exemption from Section 23A for transactions with financial subsidiaries will be eliminated. The Dodd-Frank Act will additionally prohibit an insured depository institution from purchasing an asset from or selling an asset to an insider unless the transaction is on market terms and, if representing more than 10% of capital, is approved in advance by the disinterested directors.

**Debit Card Interchange Fees.** Effective July 21, 2011, the Dodd-Frank Act requires that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the issuer. Within nine months of enactment, the Federal Reserve Board is required to establish standards for reasonable and proportional fees which may take into account the costs of preventing fraud. The restrictions on interchange fees, however, do not apply to banks that, together with their affiliates, have assets of less than \$10 billion.

**Consumer Financial Protection Bureau.** The Dodd-Frank Act creates a new, independent federal agency called the Consumer Financial Protection Bureau (“CFPB”), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB will have examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower’s ability to repay. In addition, the Dodd-Frank Act will allow borrowers to raise certain defenses to foreclosure if





they receive any loan other than a “qualified mortgage” as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

#### Regulation of Norwood

General. Norwood, as a bank holding company registered under the Bank Holding Company Act of 1956, as amended (“BHCA”), is subject to regulation and supervision by the Board of Governors of the Federal Reserve System (“Federal Reserve”) and by the Pennsylvania Department of Banking (the “Department”). Norwood is required to file annually a report of its operations with, and is subject to examination by, the Federal Reserve and the Department. This regulation and oversight is generally intended to ensure that Norwood limits its activities to those allowed by law and that it operates in a safe and sound manner without endangering the financial health of its subsidiary banks.

Under the BHCA, Norwood must obtain the prior approval of the Federal Reserve before it may acquire control of another bank or bank holding company, merge or consolidate with another bank holding company, acquire all or substantially all of the assets of another bank or bank holding company, or acquire direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company would directly or indirectly own or control more than 5% of such shares.

Federal statutes impose restrictions on the ability of a bank holding company and its nonbank subsidiaries to obtain extensions of credit from its subsidiary bank, on the subsidiary bank’s investments in the stock or securities of the holding company, and on the subsidiary bank’s taking of the holding company’s stock or securities as collateral for loans to any borrower. A bank holding company and its subsidiaries are also prevented from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property, or furnishing of services by the subsidiary bank.

A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the policy of the Federal Reserve that a bank holding company should stand ready to use available resources to provide adequate capital to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company’s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve regulations, or both.

Non-Banking Activities. The business activities of Norwood, as a bank holding company, are restricted by the BHCA. Under the BHCA and the Federal Reserve’s bank holding company regulations, Norwood may only engage in, or acquire or control voting securities or assets of a company engaged in, (1) banking or managing or controlling banks and other subsidiaries authorized under the BHCA and (2) any BHCA activity the Federal Reserve has determined to be so closely related to banking or managing or controlling banks to be a proper incident thereto. These include any incidental activities necessary to carry on those activities, as well as a lengthy list of activities that the Federal Reserve has determined to be so closely related to the business of banking as to be a proper incident thereto.

Financial Modernization. The Gramm-Leach-Bliley Act, permits greater affiliation among banks, securities firms, insurance companies, and other companies under a new type of financial services company known as a “financial holding company.” A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by



statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities. The Act also permits the Federal Reserve and the Treasury Department to authorize additional activities for financial holding companies if they are “financial in nature” or “incidental” to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, well managed, and has at least a “satisfactory” CRA rating. A financial holding company must provide notice to the Federal Reserve within 30 days after commencing activities previously determined by statute or by the Federal Reserve and Department of the Treasury to be permissible. Norwood has not submitted notice to the Federal Reserve of its intent to be deemed a financial holding company.

**Regulatory Capital Requirements.** The Federal Reserve has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the BHCA. The Federal Reserve’s capital adequacy guidelines are similar to those imposed on Wayne Bank by the Federal Deposit Insurance Corporation (“FDIC”). See “Regulation of Wayne Bank and North Penn Bank-Regulatory Capital Requirements.”

The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve’s view that a bank holding company should pay cash dividends only to the extent that the holding company’s net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company’s capital needs, asset quality and overall financial condition. The Federal Reserve also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. In a recent Supervisory Letter, the Federal Reserve staff has stated that, as a general matter, bank holding companies should eliminate cash dividends if net income available to shareholders for the past four quarters, net of dividends previously paid, is not sufficient to fully fund the dividend. Furthermore, under the federal prompt corrective action regulations, the Federal Reserve may prohibit a bank holding company from paying any dividends if the holding company’s bank subsidiary is classified as “undercapitalized.”

#### Regulation of North Penn

**General.** North Penn is regulated by the Office of Thrift Supervision as “savings and loan holding company” under the Home Owners Loan Act. Federal law allows a state savings bank that qualifies as a “qualified thrift lender” to elect to be treated as a savings association for purposes of the savings and loan holding company provisions of federal law. Such election allows its holding company to be regulated as a savings and loan holding company by the Office of Thrift Supervision rather than as a bank holding company by the Federal Reserve Board. North Penn Bank has elected to be treated as a savings association so that North Penn will be regulated as a savings and loan holding company under federal law. As such, North Penn has registered with the Office of Thrift Supervision and is subject to Office of Thrift Supervision regulations, examinations, supervision, reporting requirements and regulations concerning corporate governance and activities. In addition, the Office of Thrift Supervision has enforcement authority over North Penn and its non-savings institution subsidiaries. Among other things, this authority permits the Office of Thrift Supervision to restrict or prohibit activities that are determined to be a serious risk to North Penn Bank.

As part of the Dodd-Frank Act regulatory restructuring, the OTS’s authority over savings and loan holding companies will be transferred to the Federal Reserve Board, which is the agency that regulates and supervises bank holding companies. That change will occur one year from the July 31, 2010 enactment of the Dodd-Frank Act, subject to a possible six month extension.



As a unitary savings and loan holding company, North Penn is able to engage only in activities permitted to a financial holding company and those permitted for a multiple savings and loan holding company, which includes non-banking activities that the Federal Reserve Board has determined to be permissible for bank holding companies.

**Limitation on Capital Distributions.** Federal regulations impose limitations upon all capital distributions by a savings institution, including cash dividends, payments to repurchase its shares and payments to shareholders of another institution in a cash-out merger. Under the regulations, an application to and the prior approval of the Office of Thrift Supervision is required before any capital distribution if the institution does not meet the criteria for “expedited treatment” of applications under Office of Thrift Supervision regulations (i.e., generally, examination and Community Reinvestment Act ratings in the two top categories), the total capital distributions for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, the institution would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with the Office of Thrift Supervision. If an application is not required, the institution must still provide prior notice to the Office of Thrift Supervision of the capital distribution if, like North Penn Bank, it is a subsidiary of a holding company. If North Penn Bank’s capital were ever to fall below its regulatory requirements or regulators notified it that it was in need of increased supervision, its ability to make capital distributions could be restricted. In addition, the Office of Thrift Supervision could prohibit a proposed capital distribution that would otherwise be permitted by the regulation if the agency determines that such distribution would constitute an unsafe or unsound practice.

**Qualified Thrift Lender Test.** In order for North Penn to be regulated by the Office of Thrift Supervision as a savings and loan holding company (rather than by the Federal Reserve Board as a bank holding company) North Penn Bank must meet a qualified thrift lender test. Under the test, North Penn Bank is required to either qualify as a “domestic building and loan association” under the Internal Revenue Code or maintain at least 65% of its “portfolio assets” (total assets less: (i) specified liquid assets up to 20% of total assets; (ii) intangibles, including goodwill; and (iii) the value of property used to conduct business) in certain “qualified thrift investments” (primarily residential mortgages and related investments, including certain mortgage-backed securities) in at least 9 months out of each 12 month period. Education loans, credit card loans and small business loans may be considered “qualified thrift investments.” As of September 30, 2010, North Penn Bank met the qualified thrift lender test.

Savings and loan holding companies are not currently subject to specific regulatory capital requirements. The Dodd-Frank Act, however, requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. There is a five-year transition period (from the July 21, 2010 effective date of the Dodd-Frank Act) before the capital requirements will apply to savings and loan holding companies. Instruments such as cumulative preferred stock and trust preferred securities will no longer be includable as Tier 1 capital. Instruments issued by May 19, 2010 will be grandfathered for companies with consolidated assets of \$15 billion or less. The Dodd-Frank Act also extends the “source of strength” doctrine to savings and loan holding companies. The regulatory agencies must issue regulations requiring that all bank and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions. That requires holding companies to provide capital and other support to their subsidiary institutions in times of financial distress.

**Acquisition of Control.** Under the federal Change in Bank Control Act, a notice must be submitted to the Office of Thrift Supervision if any person (including a company), or group acting in concert, seeks to acquire “control” of a savings and loan holding company or savings association. An acquisition of “control” can occur upon the acquisition of 10% or more of the voting stock of a savings



and loan holding company or savings institution or as otherwise defined by the Office of Thrift Supervision. Under the Change in Bank Control Act, the Office of Thrift Supervision has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

**Regulatory Restructuring Legislation.** On July 21, 2010, the Dodd-Frank Act, which is legislation that restructures the regulation of depository institutions, was signed into law. In addition to providing for the elimination of the Office of Thrift Supervision and creating the Consumer Financial Protection Bureau, the Dodd-Frank Act, among other things, requires changes in the way that institutions are assessed for deposit insurance, authorizes the payment of interest on business checking accounts, mandates the imposition of consolidated capital requirements on savings and loan holding companies, requires that originators of securitized loans retain a percentage of the risk for the transferred loans, requires the Federal Reserve Board to regulate pricing of debit card interchange fees, reduces the federal preemption afforded to federal savings associations and contains a number of reforms related to mortgage origination. Many of the provisions of the Dodd-Frank Act contain delayed effective dates and require the issuance of regulations. Consequently, it will be some time before their impact on operations can be assessed by management. However, there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in an increased regulatory burden and higher compliance, operating, and possibly, interest expense costs for North Penn and North Penn Bank.

#### Regulation of the Wayne Bank and North Penn Bank

**General.** As a Pennsylvania chartered, FDIC insured commercial and savings bank, respectively, Wayne Bank and North Penn Bank are subject to extensive regulation and examination by the Pennsylvania Department of Banking and by the FDIC, which insures their deposits to the maximum extent permitted by law. The federal and state laws and regulations applicable to banks and savings banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds and the nature and amount of collateral for certain loans. The laws and regulations governing Wayne Bank generally have been promulgated to protect depositors and not for the purpose of protecting stockholders. This regulatory structure also gives the federal and state banking agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Department, the FDIC or the United States Congress, could have a material impact on Norwood, North Penn, Wayne Bank, North Penn Bank and their operations.

**Pennsylvania Banking Law.** The Pennsylvania Banking Code (“Banking Code”) contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, and employees, as well as corporate powers, savings and investment operations and other aspects of Wayne Bank and its affairs. The Banking Code delegates extensive rule-making power and administrative discretion to the Department so that the supervision and regulation of state chartered banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices. The Banking Code also provides state-chartered savings banks with all of the powers enjoyed by federal savings and loan associations, subject to regulation by the Pennsylvania Department of Banking.

The Federal Deposit Insurance Corporation Act (“FDIA”), however, prohibits state chartered banks from making new investments, loans, or becoming involved in activities as principal and equity investments which are not permitted for national banks unless (1) the FDIC determines the activity or investment does not pose a significant risk of loss to the Deposit Insurance Fund and (2) the bank meets





all applicable capital requirements. Accordingly, the additional operating authority provided to Wayne Bank by the Banking Code is significantly restricted by the FDIA.

Federal Deposit Insurance. The deposits of Wayne Bank and North Penn Bank are insured to applicable limits by the FDIC. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the maximum deposit insurance amount has been permanently increased from \$100,000 to \$250,000 and unlimited deposit insurance has been extended to non-interest-bearing transaction accounts until December 31, 2012. Prior to the Dodd-Frank Act, the FDIC had established a Temporary Liquidity Guarantee Program under which, for the payment of an additional assessment by insured banks that did not opt out, the FDIC fully guaranteed all non-interest-bearing transaction accounts until June 30, 2010 (the "Transaction Account Guarantee Program") and all senior unsecured debt of insured depository institutions or their qualified holding companies issued between October 14, 2008 and October 31, 2009, with the FDIC's guarantee expiring by December 31, 2012 (the "Debt Guarantee Program"). Norwood, North Penn, Wayne Bank and North Penn Bank did not opt out of the Debt Guarantee Program but none of them issued any debt thereunder. Wayne Bank and North Penn Bank did not opt out of the Transaction Account Guarantee Program.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. Well-capitalized institutions with the CAMELS ratings of 1 or 2 are grouped in Risk Category I and, until 2009, were assessed for deposit insurance at an annual rate of between five and seven basis points of issued deposits with the assessment rate for an individual institution determined according to a formula based on a weighted average of the institution's individual CAMELS component ratings plus either five financial ratios or the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV were assessed at annual rates of 10, 28 and 43 basis points, respectively.

Starting in 2009, the FDIC significantly raised the assessment rate in order to restore the reserve ratio of the Deposit Insurance Fund to the statutory minimum of 1.15%. For the quarter beginning January 1, 2009, the FDIC raised the base annual assessment rate for institutions in Risk Category I to between 12 and 14 basis points while the base annual assessment rates for institutions in Risk Categories II, III and IV were increased to 17, 35 and 50 basis points, respectively. For the quarter beginning April 1, 2009 the FDIC set the base annual assessment rate for institutions in Risk Category I to between 12 and 16 basis points and the base annual assessment rates for institutions in Risk Categories II, III and IV at 22, 32 and 45 basis points, respectively. An institution's assessment rate could be lowered by as much as five basis points based on the ratio of its long-term unsecured debt to deposits or, for smaller institutions based on the ratio of certain amounts of Tier 1 capital to adjusted assets. The assessment rate may be adjusted for Risk Category I institutions that have a high level of brokered deposits and have experienced higher levels of asset growth (other than through acquisitions) and could be increased by as much as ten basis points for institutions in Risk Categories II, III and IV whose ratio of brokered deposits to deposits exceeds 10%. Reciprocal deposit arrangements like CDARS® were treated as brokered deposits for Risk Category II, III and IV institutions but not for institutions in Risk Category I. An institution's base assessment rate would also be increased if an institution's ratio of secured liabilities (including FHLB advances and repurchase agreements) to deposits exceeds 25%. The maximum adjustment for secured liabilities for institutions in Risk Categories I, II, III and IV would be 8, 11, 16 and 22.5 basis points, respectively, provided that the adjustment may not increase an institution's base assessment rate by more than 50%.

The FDIC imposed a special assessment equal to five basis points of assets less Tier 1 capital as of June 30, 2009, payable on September 30, 2009, and reserved the right to impose additional special assessments. In November, 2009, instead of imposing additional special assessments, the FDIC amended the assessment regulations to require all insured depository institutions to prepare their estimated risk-



based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012 on December 30, 2009. For purposes of estimating the future assessments, each institution's base assessment rate in effect on September 30, 2009 was used, assuming a 5% annual growth rate in the assessment base and a 3 basis point increase in the assessment rate in 2011 and 2012. The prepaid assessment will be applied against actual quarterly assessments until exhausted. Any funds remaining after June 30, 2013 will be returned to the institution. If the prepayment would impair an institution's liquidity or otherwise create significant hardship, it may apply for an exemption. Requiring this prepaid assessment does not preclude the FDIC from changing assessment rates or from further revising the risk-based assessment system.

The Dodd-Frank Act requires the FDIC to take such steps as necessary to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020. In setting the assessments, the FDIC is required to offset the effect of the higher reserve ratio against insured depository institutions with total consolidated assets of less than \$10 billion. The Dodd-Frank Act also broadens the base for FDIC insurance assessments so that assessments will be based on the average consolidated total assets less average tangible equity capital of a financial institution rather than on its insured deposits. The FDIC has adopted a new restoration plan to increase the reserve ratio to 1.15% by September 30, 2020 with additional rulemaking scheduled for 2011 regarding the method to be used to achieve a 1.35% reserve ratio by that date and offset the effect on institutions with assets less than \$10 billion in assets. Pursuant to the new restoration plan, the FDIC will forgo the 3 basis point increase in assessments scheduled to take effect on January 1, 2011. The FDIC has proposed new assessment regulations that would redefine the assessment base as average consolidated assets less average tangible equity. The proposed regulations would use the current assessment rate schedule with modifications to the unsecured debt and brokered deposit adjustments and the elimination of the secured liability adjustment.

In addition, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the Federal Savings and Loan Insurance Corporation. The FICO assessment rates, which are determined quarterly, averaged .01% of insured deposits on an annualized basis in fiscal year 2009. These assessments will continue until the FICO bonds mature in 2017.

**Regulatory Capital Requirements.** The FDIC has promulgated capital adequacy requirements for state-chartered banks that, like Wayne Bank and North Penn Bank, are not members of the Federal Reserve System. At September 30, 2010, Wayne Bank and North Penn Bank each exceeded all regulatory capital requirements and was classified as "well capitalized."

The FDIC's capital regulations establish a minimum 3% Tier I leverage capital requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively increases the minimum Tier I leverage ratio for such other banks to 4% to 5%. Under the FDIC's regulation, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System. Tier I or core capital is defined as the sum of common stockholders' equity (including retained earnings), noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain servicing and purchased credit card relationships, and minus certain other listed assets.

The FDIC's regulations also require that state-chartered, non-member banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of total capital (which is defined as Tier I capital and supplementary (Tier 2) capital) to risk weighted assets of 8%. In determining



the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset or item. The components of Tier I capital for the risk-based standards are the same as those for the leverage capital requirement. The components of supplementary (Tier 2) capital include cumulative perpetual preferred stock, mandatory subordinated debt, perpetual subordinated debt, intermediate-term preferred stock, up to 45% of unrealized gains on equity securities and a bank's allowance for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of supplementary capital that may be included in total capital is limited to 100% of Tier I capital.

A bank that has less than the minimum leverage capital requirement is subject to various capital plan and activities restriction requirements. The FDIC's regulations also provide that any insured depository institution with a ratio of Tier I capital to total assets that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the FDIA and could be subject to potential termination of deposit insurance.

Wayne Bank and North Penn Bank are also subject to minimum capital requirements imposed by the Department on Pennsylvania-chartered depository institutions. Under the Department's capital regulations, a Pennsylvania bank or savings bank must maintain a minimum leverage ratio of Tier 1 capital (as defined under the FDIC's capital regulations) to total assets of 4%. In addition, the Department has the supervisory discretion to require higher leverage ratio for any institutions based on the institution's substandard performance in any of a number of areas. Wayne Bank and North Penn Bank were in compliance with both the FDIC and Pennsylvania capital requirements as of September 30, 2010.

**Affiliate Transaction Restrictions.** Federal laws strictly limit the ability of banks to engage in transactions with their affiliates, including their bank holding companies. In particular loans by a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of a bank subsidiary's capital and surplus and, with respect to such parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary's capital and surplus. Further, loans and other extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that all transactions between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

**Loans to One Borrower.** Under Pennsylvania law, commercial banks, like Wayne Bank, have, subject to certain exemptions, lending limits to one borrower in an amount equal to 15% of the institution's capital accounts. An institution's capital account includes the aggregate of all capital, surplus, undivided profits, capital securities and general reserves for loan losses. Pursuant to the national bank parity provisions of the Banking Code, Wayne Bank may also lend up to the maximum amounts permissible for national banks, which are allowed to make loans to one borrower of up to 25% of capital and surplus in certain circumstances. As of September 30, 2010, loans-to-one-borrower limitation was \$10.2 million and Wayne Bank was in compliance with such limitation. Under the Banking Code, the board of directors of a state savings bank like North Penn Bank is allowed to set its own loans-to-one-borrower limits.

**Federal Home Loan Bank System.** Wayne Bank and North Penn Bank are members of the FHLB of Pittsburgh, which is one of 12 regional FHLBs. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the Board of Trustees of the FHLB.

As FHLB members, Wayne Bank and North Penn Bank are required to purchase and maintain restricted stock in the FHLB of Pittsburgh in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of the Bank's outstanding advances from the FHLB. At September 30, 2010, Wayne Bank was in compliance with this requirement. In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of excess capital stock. The FHLB has reinstated the limited repurchase of excess capital stock. Management evaluates the restricted stock for impairment in accordance with Statement of Position (SOP) 01-6, Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or Finance the Activities of Others. Management's determination of whether these investments are impaired is based on the assessment of the ultimate recoverability of their costs rather than by recognizing temporary declines in value. The managements of Wayne Bank and North Penn Bank believe no impairment charge was necessary related to FHLB stock as of September 30, 2010.

Federal Reserve System. The Federal Reserve requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking and NOW accounts) and non-personal time deposits. The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy the liquidity requirements that are imposed by the Department. At September 30, 2010, Wayne Bank and North Penn Bank met their reserve requirements.

Restrictions on Dividends. The Pennsylvania Banking Code states, in part, that dividends may be declared and paid only out of accumulated net earnings and may not be declared or paid unless surplus (retained earnings) is at least equal to contributed capital. Wayne Bank and North Penn Bank have not declared or paid any dividends which cause their retained earnings to be reduced below the amount required. Finally, dividends may not be declared or paid if a bank is in default in payment of any assessment due the FDIC.

#### MANAGEMENT FOLLOWING THE MERGER

Set forth below is biographical and other information regarding the individuals who will serve as directors and executive officers of Norwood after the merger. With the exception of Mr. Lamont, all such individuals currently serve as directors and executive officers of Norwood.

Richard L. Snyder, age 70, is a retired executive and certified public accountant. He served in a number of executive positions with Pricewaterhouse Coopers LLP, Bell Equipment/Alcom Combustion Company, and most recently with Phillip Morris Companies, Inc.

Ralph A. Matergia, age 61, is a founding partner of the law firm of Matergia and Dunn in Stroudsburg, Pennsylvania with which he has practiced for over 25 years. He has served as the Solicitor for the Borough of Stroudsburg since 1979 and as Solicitor for the Monroe County Treasurer for over 25 years.

Dr. Andrew A. Forte, age 52, is the President of Forte, Inc., a family owned corporation which operates the Stroudsmoor Country Inn, a hospitality and banquet facility in Stroudsburg, Pennsylvania. He has Doctoral Degree in management from the Lubin School of Business, Pace University. He is a Certified Public Accountant, who practiced public accountancy with KPMG Peat Marwick as an Audit Manager through June 1985.

Daniel J. O'Neill, age 73, is an Adjunct Professor at Wilkes University, the retired Superintendent of the Wayne Highlands School District, Honesdale, Pennsylvania, and Commander 28th Infantry Division (Retired).

Dr. Kenneth A. Phillips, age 60, is an optometrist in Waymart, Pennsylvania. Dr. Phillips has in-depth knowledge of Wayne Bank's market area and is active in various community activities.

William W. Davis, Jr., age 66, served as President and Chief Executive Officer of Norwood and Wayne Bank until his retirement on December 31, 2009.

John E. Marshall, age 73, is president of Marshall Machinery, Inc., Honesdale, Pennsylvania, a local compact tractor and light industrial dealer. Through his business, Mr. Marshall deals with a variety of contractors and developers.

Susan Gumble-Cottell, age 53, is the President and Chief Executive Officer of Gumble Brothers, Inc., a building materials supplier located in Paupack, Pennsylvania. She works with various contractors and builders and has knowledge of the local construction market.

Lewis J. Critelli, age 51, was named President and Chief Executive Officer effective January 1, 2010. He had served as Executive Vice President, Secretary and Chief Financial Officer of Norwood and Wayne Bank since 1998 after joining Wayne Bank in 1995.

Kevin M. Lamont, age 52, is the Chairman of the Board of North Penn and North Penn Bank. He is also President of Millennium Health Services, Inc. and President of Lamont Development Company, Inc. Mr. Lamont developed, owned and operated two major assisted living communities in Northeast Pennsylvania. Mr. Lamont has been a licensed Nursing Home Administrator in Pennsylvania since 1980 and has extensive experience in all aspects of business management and finance. Mr Lamont will become a member of the board upon completion of the merger.

Executive Officers Who Are Not Directors:

Edward C. Kasper, age 63, is Executive Vice President of Norwood and Executive Vice President and head of Corporate Banking for Wayne Bank.

Kenneth C. Doolittle, age 53, was named Executive Vice President in December 2009. He joined Wayne Bank as Vice President in May 2009. Prior to joining Wayne Bank, he had served as chief operating officer of Pennstar Bank, Scranton, Pennsylvania, a subsidiary of NBT Bancorp.

Joseph A. Kneller, age 64, is Senior Vice President of Norwood and Senior Vice President - Information Systems of Wayne Bank.

John H. Sanders, age 53, is Senior Vice President of Norwood and Senior Vice President and head of Retail Banking for Wayne Bank.

William S. Lance, age 51, was named Senior Vice President and Chief Financial Officer in March 2010. Prior to joining Norwood, he had served as Chief Financial Officer of First National Community Bank, Dunmore, Pennsylvania for over 15 years.



## Director Independence

The Board of Directors has determined that Directors Snyder, Phillips, Matergia, Marshall, O'Neill, Gumble-Cottell and Forte are independent under the independence standards of The Nasdaq Global Market on which the Norwood common stock is currently listed. In determining the independence of directors, the Board of Directors considered the deposit and loan relationships which various directors have with Wayne Bank and certain business relationships between Wayne Bank and organizations in which certain directors have an interest. In determining whether Mr. Matergia is independent, the Board of Directors considered work occasionally done by his law firm for Wayne Bank but determined that due to the small volume of work done, his independence was not affected. There are no members of the Audit Committee who do not meet the independence standards of the The Nasdaq Global Market for Audit Committee members and no members of the Audit Committee are serving under any exceptions to these standards.

## Compensation Committee Interlocks and Insider Participation

The Compensation Committee consisted of Directors Marshall, Matergia and Snyder at December 31, 2009. Director Marshall is Chairman of the Board of Norwood and Wayne Bank and serves as Chairman of the Compensation Committee. Members of the Compensation Committee are non-employee directors of Norwood and Wayne Bank. No member of the Committee or any other director is, or was during 2009, an executive officer of another company whose board of directors has a comparable committee on which one of Norwood's executive officers serves. None of the executive officers of Norwood is, or was during 2009, a member of the board of directors or a comparable compensation committee of a company of which any of the directors of Norwood is an executive officer.

## Compensation Discussion and Analysis

**Philosophy and Objectives.** Norwood's compensation programs are designed to effectively attract, retain, motivate and reward Named Executive Officers (NEOs) and all employees for their performance. Norwood believes in maintaining a competitive compensation package to insure continuity of the management team with the goal of increasing shareholder value over the long-term.

The objectives of the compensation package include the following:

- Create an overall compensation package that is competitive with those offered by other financial institutions in our market area while providing appropriate incentives for the achievement of short and long term performance goals.
- Encourage achievement of short-term performance goals through cash incentive programs
- Use stock incentive plans to reward long-term performance and align interests of management with shareholders
- Encourage long-term management continuity and loyalty through the accrual of post-employment benefits

Financial services is a competitive industry and Norwood operates in a market area which is headquarters to many other community banks as well as much larger institutions. The NEOs officer compensation package is therefore structured to keep the current team in place. Norwood feels this is important due to the following attributes of the NEOs:



- In depth knowledge of the local markets
- Familiarity with Norwood's operations
- Strong customer relationships
- Management succession planning
- Proven success
- Over twelve consecutive years of earnings growth and dividend increases

Norwood has a balanced package of short-term cash based compensation and longer-term stock based plans and retirement plans. Norwood's Executive Compensation package includes the following key elements:

- Base Salary
- Cash Incentive Bonus Plan
- Long Term Equity-Based Incentive Compensation
- Employment Agreements
- Post-Employment and Retirement Programs
- Insurance and Other Benefits
- Perquisites and other Personal Benefits

Administration of Compensation Program. The Compensation Committee of Norwood is responsible for the administration of the compensation program of the President, Chief Executive Officer and Chief Financial Officer and the other Named Executive Officers.

The Compensation Committee meets in December of each year to determine annual salary adjustments, cash bonus and stock option awards for NEOs. Norwood does not have a formal policy addressing each specific type of compensation.

The Committee does consider a variety of factors as it evaluates compensation for each NEO, including:

- Overall company performance as compared to budget and prior year's performance;
- Bank regulatory examination results;
- Bank performance metrics compared to peers, including return on assets, return on equity, charge-offs, level of non-performing loans and efficiency ratio; and
- The individual achievements of each NEO in their respective areas of responsibility.

In establishing base salaries and increases, the committee has access to various compensation surveys to ensure a competitive salary level. These include:

- The Conference Board Salary increase survey
- The Nash and Company PA Bank and Thrift Compensation Report
- SNL Executive Compensation Review

Norwood does not specifically benchmark compensation to any specific group of companies.

The peer group consists of the following banks in northeast Pennsylvania: Community Bank & Trust, Dime Bank, Penn Security, Honesdale National, First Keystone National, Fidelity Deposit & Discount, Luzerne Bank and First National Community Bank.

Annual salary increases are generally made in amounts deemed necessary to maintain the competitiveness of the salary structure. Absent a material increase in duties or a significant change in the economic or competitive landscape, salaries are not increased materially from year to year.

At each meeting, the Chief Executive Officer discusses with the Committee the performance evaluations of each of the NEOs excluding himself, and presents his recommendations. The Chief Executive Officer is not present for any discussion involving his compensation.

Depending on Norwood's performance for the year, the Compensation Committee establishes a cash incentive bonus pool based on a percentage of pre-tax earnings. Specific bonus amounts are awarded to each NEO based on performance. Norwood realizes that all employees contribute to its success, and therefore, cash bonuses are also distributed to employees at all levels based on merit. Norwood has never been required to materially adjust or restate the pre-tax earnings on which the bonus pool has been calculated and does not have a policy regarding the adjustment or recovery of bonuses in such an event.

The Committee also grants stock option awards under the Norwood Financial Corp. 2006 Stock Option Plan. The Stock Option Plan was designed to provide long-term incentives to NEOs, directors and other key employees that contribute to the success of Norwood. The ten-year life of the options is structured to retain the NEOs and promote the long-term success of Norwood.

The Board of Directors believes that equity-based compensation is important in aligning the interests of management with those of shareholders and has established the Wayne Bank Employee Stock Ownership Plan and 2006 Stock Option Plan to help it achieve this objective. Although each of the NEOs has a substantial personal investment in the Common Stock, the Board of Directors does not have formal equity ownership requirements or guidelines for executive officers.

Components of Compensation Program. The components of compensation for 2009 are as follows:

#### Salary

As a result of Norwood's ongoing success and the continuity of the management team, current base salary levels are above the median. The Compensation Committee approved a 3.00% increase in salaries at the December meeting. This level was based on information from the Conference Board which indicated commercial banks would increase officer salaries by 3.00%. NEOs salary increases ranged from 2.5% to 2.9% excluding increases related to any material changes in duties. Under their employment agreements as in effect in 2009, Messrs. Davis and Critelli had base salary amounts of \$226,000 and \$141,500, respectively, with minimum annual increases of \$6,000 and \$3,000, respectively.

#### Bonus

For 2009, the Board approved a bonus pool equal to 4.0% of pre-tax earnings to be distributed to all NEOs, other officers and employees. Historically, this bonus pool percentage has varied from 4.0% to 4.4% of pre-tax earnings. In establishing this bonus pool, the Committee considered Norwood's overall



performance including an increase in earnings and ROA, ROE, the efficiency ratio and loan quality each of which ranks in the top quartile of Norwood's peer group.

#### Stock Based Awards

The Compensation Committee approved stock option awards under the Norwood Financial Corp. 2006 Stock Option Plan. The purpose of the plan is to provide incentives and rewards to officers, employees and directors that contribute to the success and growth of Norwood. In 2009, a total of 20,000 options were granted to 22 key employees including the NEOs. Because Mr. Davis had announced his retirement effective as of December 31, 2009, the Compensation Committee determined not to award options to him. Of the total options granted in 2009, 20,000, which represents .72% of total shares outstanding, related to Norwood's 2009 performance. The NEOs were awarded 38% of the total options granted. The percentage awarded to NEOs has declined over time as more key employees have been included in the plan.

#### Timing of Grants

Stock awards are typically granted annually as part of the individual performance review process. This takes place at the Compensation Committee Meeting in December. The full board ratifies the actions of the Committee in December and establishes the grant date. The exercise price is based upon the last sale price of Norwood's stock at the closing on the effective date of grant or if there is no trading on such date then the last trading day prior to such date of grant. As described above, grants for 23,000 shares were awarded effective December 31, 2009.

#### Retirement and Severance Arrangements

Norwood has salary continuation plan agreements (SCP) with each NEO. The agreements provide that upon termination of employment on or after reaching age 62, or following a change-in-control, if earlier, the NEOs will be eligible to receive annual retirement benefits as detailed in the Pension Benefits Table below. The SCP was initially established in 1999. Benefit amounts were calculated based on the amount of supplemental retirement income needed to allow the NEO to retire on approximately 40-75% of projected final salary when such supplemental benefit is added to Norwood's qualified retirement plans and social security. The range of 40% to 75% of final salary is based on total years of service with Norwood from inception date of the plan. The target supplemental salary levels payable at normal retirement age as follows: up to 15 years of service – 40%, 15-25 years – 65% and 25 or more – 75%.

The NEOs participate in Wayne Bank's defined contribution profit-sharing and 401(k) Plan which is open to all employees over the age of 21 after one year of employment. The 401(k) Plan permits employees to make pre-tax contributions of between 2% and 10% of their compensation to their accounts in the 401(k) Plan and Wayne Bank will match the first 2% of the contribution. In addition, in December 2009, the Compensation Committee approved an additional corporate contribution equal to 7% of each eligible employee's compensation. The Committee considers the financial performance of Norwood when it sets Norwood's annual contribution under the plan. For each NEO, Norwood contributed a total of 9% of the NEO's base salary to the Plan, the same percentage as for all eligible employees who contributed at least 2% of their compensation to their account.

Each of the NEOs participate in the Employee Stock Ownership Plan (ESOP) which is open to all employees who have met the eligibility requirements. (See Note 9 of Notes to the Consolidated Financial Statements.)

As part of the long-term compensation package, Norwood and Wayne Bank have entered into a three-year employment agreement with Mr. Critelli. The agreement has a two step change-in-control trigger under which, in case of a voluntary termination within 30 days of a change-in-control or an involuntary termination or voluntary termination for good reason during the six months before or within one year after a change-in-control, the NEO would be paid a lump sum amount equal to three times the five-year average of his annual compensation less \$1.00. We believe that the change-in-control provision is desirable in order to ensure that Mr. Critelli remains focused on the interests of Norwood and its shareholders in the event of a pending change-in-control. In the event of a change in control, Norwood will indemnify the NEOs for any 20% tax penalties that may be incurred by them for amounts payable that exceed the limitations under Sections 280G and 4999 of the Internal Revenue Code. If Norwood terminated Mr. Critelli, without just cause, he would be entitled to a payment of salary for amounts due under the agreement with a minimum severance payment of one year's salary.

The Compensation Committee balances short-term and long-term compensation for the NEOs. Long term compensation includes stock option grants, salary continuation plan and other benefits available to all employees which include contributions to 401(k) Plan, ESOP and life insurance. For 2009, the target range for short-term compensation as a percentage of total compensation was 70% to 80% with long-term compensation at 20% to 30% of total compensation. We believe this formula is competitive within our market place and peer group.

#### Executive Compensation

Summary Compensation Table. The following table sets forth the cash and non-cash compensation awarded to or earned during the last three fiscal years by our principal executive officer, principal financial officer and the three other most highly compensated executive officers whose total compensation (excluding compensation attributable to changes in pension value and non-qualified deferred compensation earnings) during the fiscal year ended December 31, 2009 exceeded \$100,000 for services rendered in all capacities to Norwood and Wayne Bank. Norwood does not have any plans providing for stock awards or non-equity incentive compensation to the Named Executive Officers.

Name and Principal Position	Year	Salary	Bonus	Option Awards (1)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (2)	All Other Compensation(3)	Total
William W. Davis, Jr. * President and Chief Executive Officer	2009	\$ 256,584	\$ 72,000	\$ 0	\$ 25,452	\$ 314,571	\$ 668,607
	2008	241,000	80,000	16,290	13,134	36,256	386,680
	2007	234,000	80,000	20,970	19,995	42,314	397,279
Lewis J. Critelli * President and Chief Executive Officer	2009	\$ 167,192	\$ 47,250	\$ 20,310	\$ 20,336	\$ 28,542	\$ 283,630
	2008	156,500	52,500	13,575	18,879	27,829	269,283
	2007	151,500	50,000	17,475	17,517	26,430	262,921
Edward C. Kasper Executive Vice President	2009	\$ 127,731	\$ 30,150	\$ 10,155	\$ 29,458	\$ 23,171	\$ 220,665
	2008	120,000	33,500	8,145	33,741	22,617	218,003
	2007	117,000	32,000	10,485	31,314	22,652	213,451
John H. Sanders Senior Vice President	2009	\$ 113,192	\$ 16,650	\$ 6,770	\$ 9,669	\$ 19,573	\$ 165,854
	2008	106,000	18,500	5,430	8,972	19,145	160,762
	2007	103,000	17,500	6,990	8,328	17,977	153,795
Joseph A. Kneller Senior Vice President	2009	\$ 111,115	\$ 12,150	\$ 6,770	\$ 5,085	\$ 141,331	\$ 276,451
	2008	104,000	13,500	5,430	15,141	18,629	156,700
	2007	101,000	13,000	6,990	17,514	18,467	156,971

\* Mr. Davis retired effective as of December 31, 2009 and Mr. Critelli was named President and Chief Executive Officer effective January 1, 2010. Mr. Critelli served as Chief Financial Officer during fiscal year 2009.

(1) Based on the aggregate grant date fair value of the award computed in accordance with FASB ASC Topic 718. For assumptions used in determining the grant date fair value of the options, see Note 13 of Notes to the Consolidated Financial Statements.

(2) Consists of increase in actuarial present value of benefits under Salary Continuation Plan.

(3) All other compensation consists of the following:

	401(k) Matching Contributions	Life Insurance Paid	Payout of Post Retirement Life Insurance	ESOP No. of Shares	ESOP Value at \$28.59/Share	Total
William W. Davis, Jr.	\$ 23,093	\$ 3,301	\$ 276,227	418	\$ 11,951	\$ 314,571



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L e w i s J .			--			
Critelli	15,047	1,573		417	11,922	28,542
Edward C. Kasper	11,496	1,897	--	342	9,778	23,170
J o h n H .			--			
Sanders	10,187	1,466		277	7,919	19,571
J o s e p h A .						
Kneller	10,000	1,764	124,135	190	5,432	141,331

Grants of Plan-Based Awards. The following tables set forth certain information with respect to plan-based awards granted to the Named Executive Officers. All grants were made under the Norwood Financial Corp. 2006 Stock Option Plan.

Name	Grant Date	Board Action Date *	All Other Option Awards:		
			Number of Securities Underlying Option (#)	Exercise of Base Price of Option Awards (\$/Sh)	Grant Date Fair Value of Stock Option Awards
William W. Davis, Jr.	NA	NA	--	\$ --	\$ --
Lewis J. Critelli	12/31/2009	12/08/2009	3,000	28.59	20,310
Edward C. Kasper	12/31/2009	12/08/2009	1,500	28.59	10,155
John H. Sanders	12/31/2009	12/08/2009	1,000	28.59	6,770
Joseph A. Kneller	12/31/2009	12/08/2009	1,000	28.59	6,770

\*Option awards were approved by the Board of Directors on December 8, 2009 to be effective on the last business day of the year. The exercise price was equal to the fair market value of the Common Stock on the Grant Date in each case.

Lewis J. Critelli has entered into a three-year employment agreement with Wayne Bank. The employment agreement provides for annual one-year renewals on each anniversary date of the agreements unless either party provides prior written notice to the contrary. The agreement provides that the Board of Directors will review his salary not less often than annually and shall increase his base salary by no less than \$5,000 per year. The employment agreement provides that Mr. Critelli will participate equitably in discretionary bonuses that the Board of Directors may award to senior management from time to time. Mr. Critelli is also entitled to participate in specified benefit plans and in any fringe benefits made available to senior management.

For fiscal year 2009 the Board of Directors increased the base salaries of the Named Executive Officers by approximately 2.5% to 2.9% each based on projected average salary increases in the banking industry and individual performance. The Board of Directors established a bonus pool for all employees equal to 4% of pre-tax earnings. Cash bonuses were awarded to the Named Executive Officers based on a percentage of the total pool relating to the Compensation Committee's judgment as to their relative contribution to the success of Norwood.

Consistent with its objective of using equity-based compensation as incentives for long-term performance and to align the interests of management with those of shareholders, the Board of Directors awarded options to the Named Executive Officers (other than Mr. Davis) in December 2009. The 2009 grants were made effective as of the last trading day on the year. In each case, the options do not vest and become exercisable until one year from the date of grant. Award amounts were based on the Compensation Committee's assessment of the relative contribution to Norwood's success. Approximately 38% of options awarded in 2009 were awarded to the Named Executive Officers with the remaining options granted to other officers of Wayne Bank. Using the Black-Scholes Option Pricing Model

and the assumptions described on Note 13 of Notes to the Consolidated Financial Statements, we determined that the fair value of each option granted in December 2009 was \$6.77.

In accordance with SEC regulations, the Summary Compensation Table treats the increase in the present value of the Named Executive Officer's retirement benefit under the Salary Continuation Plan as an item of compensation. The Salary Continuation Plan provides that the Named Executive Officers will

receive a fixed annual payment beginning at retirement at age 62 for a period of 15 years. The increase in present value is a function of the annual accrual to fully vest the Named Executive Officer at retirement age.

The Summary Compensation Table includes various miscellaneous income items under “All Other Compensation.” Under Norwood’s 401(k) Plan, eligible employees may annually contribute between 2% and 10% of their compensation to their accounts in the 401(k) Plan. Norwood generally matches employee contributions up to 2% of salary. In 2009, Norwood made an additional contribution of 7% of salary. Since the Named Executive Officers each contributed at least 2% of salary, a contribution of 9% was made to each of their accounts. Norwood pays premiums on life insurance coverage for all eligible employees including the Named Executive Officers with insurance coverage of three times base salary. Each Named Executive Officer also participates in the Wayne Bank Employee Stock Ownership Plan.

Outstanding Equity Awards at Fiscal Year End. The following table sets forth information concerning outstanding equity awards of the Named Executive Officers at fiscal year end. There were no stock awards outstanding at fiscal year-end.

Name	Number of Securities Underlying Unexercised Options Exercisable	Option Awards		
		Number of Securities Underlying Unexercised Options Unexercisable	Option Exercise Price	Option Expiration Date
William W. Davis, Jr.	3,000		\$ 27.50	12/31/2018
	3,000		31.25	12/31/2017
	3,000		31.50	12/29/2016
	4,200		30.38	04/25/2016
	4,200		30.00	12/14/2014
	4,200		23.95	12/09/2013
Lewis J. Critelli		3,000 (1)	\$ 28.59	12/31/2019
	2,500		27.50	12/31/2018
	2,500		31.25	12/31/2017
	2,500		31.50	12/29/2016
	3,150		30.38	04/25/2016
	3,150		30.00	12/14/2014
	3,150		23.95	12/09/2013
	3,150		19.05	12/10/2012
400		10.36	12/12/2010	
Edward C. Kasper		1,500 (1)	\$ 28.59	12/31/2019
	1,500		27.50	12/31/2018
	1,500		31.25	12/31/2017
	1,500		31.50	12/29/2016
	2,100		30.38	04/25/2016
	2,625		30.00	12/14/2014
	2,625		23.95	12/09/2013
John H. Sanders		1,000 (1)	\$ 28.59	12/31/2019
	1,000		27.50	12/31/2018
	1,000		31.25	12/31/2017
	1,000		31.50	12/29/2016
	1,575		30.38	04/25/2016
	1,575		30.00	12/14/2014
1,575		23.95	12/09/2013	
Joseph A. Kneller		1,000 (1)	\$ 28.59	12/31/2019
	1,000		27.50	12/31/2018
	1,000		31.25	12/31/2017

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1,000	31.50	12/29/2016
1,575	30.38	04/25/2016
1,575	30.00	12/14/2014
1,575	23.95	12/09/2013

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(1) Award vests and becomes exercisable on December 31, 2010.

Option Exercises and Stock Vested. The following table provides information regarding exercises of options and vesting of stock awards during the last fiscal year for each Named Executive Officer. Norwood does not have a stock awards plan.

Name	Option Awards	
	Number of Shares Acquired on Exercise	Value Realized on Exercise (1)
William W. Davis, Jr.	8,663	\$ 106,173
Lewis J. Critelli	9,050	143,695
Edward C. Kasper	7,089	120,973
John H. Sanders	3,150	45,707
Joseph A. Kneller	--	--

(1) Equals the difference between the exercise price and fair market value of the underlying common stock on the date of exercise times the number of options exercised.

Pension Benefits. The following table provides information with respect to each defined benefit pension plan in which a Named Executive Officer may receive payments or other benefits at, following, or in connection with retirement.

Name	Plan Name	Number Of Years Credited Service (1)	Present Value of Accumulated Benefit (2)	Payments During Last Fiscal Year
William W. Davis, Jr.	Salary Continuation Plan	10 years	\$476,003	\$ --
Lewis J. Critelli	Salary Continuation Plan	10 years	151,252	--
Edward C. Kasper	Salary Continuation Plan	10 years	263,301	--
John H. Sanders	Salary Continuation Plan	10 years	71,879	--
Joseph A. Kneller	Salary Continuation Plan	10 years	132,195	--

(1) The credited years of service are based on the plan date of 1999.

(2) Amount shown is present value of total payments over payout term using a 7.50% discount rate.

Wayne Bank has entered into salary continuation agreements with the Named Executive Officers. The purpose of the salary continuation plan is to provide the Named Executive Officers with an additional retirement benefit in excess of the maximum benefit payable under the tax-qualified 401(k) plan. The agreements provide that upon termination of employment on or after reaching the age of 62, Messrs. Davis, Critelli, Kasper, Sanders and Kneller will be entitled to an annual retirement benefit equal to \$53,289, \$61,000, \$30,061, \$24,000 and \$14,751, respectively, payable over 15

years. The retirement benefit is fixed and not dependent on pre-retirement compensation. In the event of death during active service, the Named Executive Officer's beneficiary will be entitled to the normal retirement benefit commencing on the date of death. In the event of disability or early termination for a reason other than death, disability, cause or following a change-in-control, the Named Executive Officers are entitled to a reduced benefit payable beginning with 90 days of disability in the case of disability or at normal retirement age in the case of early termination. The amounts payable under early termination and disability are based upon the plan years in which the event occurred. If the Named Executive Officers work past age 62, they are eligible for an increased benefit of 4% per year, pro rated at 0.3274% per month compounded up to age 65. The Named Executive Officers are not entitled to benefits in the event they are terminated for cause. On a change of control of Norwood, Norwood will pay the normal



retirement benefit to the Named Executive Officers in 12 equal monthly installments payable on the first day of each month commencing with the month following attaining age 62 and continuing for 179 additional months. The Named Executive Officers will not be entitled to any benefit if they violate certain non-compete provisions including becoming employed by or participating in the management of another bank or thrift following a termination of employment. These non-compete provisions, however, do not apply following a change-in-control.

Potential Payments Upon Termination or Change-in-Control. The Named Executive Officers are parties to various agreements that provide for payments in connection with any termination of their employment. The following table shows the payments that would be made to the Named Executive Officers at, following or in connection with any termination of their employment in the specified circumstances as of the last business day of the last fiscal year.

Name and Plan	Voluntary Termination	Early Termination	Normal Retirement	Involuntary Not For Cause Termination	For Cause Termination	Change-in-Control Termination	Disability	Death
William W. Davis, Jr. (4) Employment Agreement(1) Salary Continuation Plan(2)	\$ —	\$ —	\$ —	\$ 537,333	\$ —	\$ 699,900	\$ —	\$ —
	478,958	478,958	478,958	478,958	—	478,958	478,958	476,958
Lewis J. Critelli Employment Agreement(1) Salary Continuation Plan(2) Stock Option Plan(3)	—	—	—	348,833	—	454,200	—	—
	357,708	357,708	548,357	357,708	—	548,357	145,844	548,357
	—	—	—	—	—	20,310	20,310	20,310
Edward C. Kasper Salary Continuation Plan(2) Stock Option Plan(3)	260,694	260,694	260,694	260,694	—	260,694	225,023	260,694
	—	—	—	—	—	10,155	10,155	10,155
John H. Sanders Salary Continuation Plan(2) Stock Option Plan(3)	146,384	146,384	215,747	146,384	—	215,747	69,254	215,747
	—	—	—	—	—	6,770	6,770	6,770

Joseph A.  
Kneller

Salary  
Continuation  
Plan(2)  
Stock Option  
Plan(3)

140,127	140,127	140,127	140,127	—	140,127	140,127	140,127
—	—	—	—	—	6,770	6,770	6,770

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- (1) Amount shown is lump sum payment to which named executive officer would be entitled in the event of a change-in-control or the remainder payments under the contract in the event of an involuntary not for cause termination. Certain amounts may be eligible for tax-gross up to indemnify the NEO for any tax penalties incurred. The amounts shown do include this effect.
  - (2) Amount shown is present value of 180 months of payments over payout term using a 7.50% discount rate.
  - (3) Amount shown is equal to fair value of unvested portion of options at December 31, 2009 calculated using the Black-Scholes Option Pricing Model and the assumptions contained in Note 13 of Notes to Consolidated Financial Statements. Since the only unvested options were granted on December 31, 2009 at an exercise price equal to the fair market value of the Common Stock on the date of grant, there was no excess of fair market value over exercise price at that date
  - (4) Mr. Davis retired as President and Chief Executive Officer effective December 31, 2009 and his employment agreement is no longer in effect.

Employment Agreement. Under his Employment Agreement, Norwood or Wayne Bank may terminate Mr. Critelli's employment at any time for "just cause" as defined in the Agreement without further liability. If Norwood or Wayne Bank terminated Mr. Critelli without just cause, he would be entitled to a continuation of his salary for the remaining term of the Agreement with a minimum of one year from the date of termination as well as the continuation of other benefits. In the event of an involuntary termination or voluntary termination with good reason during the period beginning six months prior and ending one year after a change in control, Mr. Critelli will be paid in a lump sum an amount equal to three times the five-year average of his annual compensation minus \$1.00. Under the Agreements, Mr. Critelli is prohibited from competing with Wayne Bank for one year if his employment is terminated for just cause or he resigns for a reason other than good reason.

Salary Continuation Plan. For a description of the Salary Continuation Plan, see " – Pension Benefits" above.

Stock Option Plan. The stock option plan provides that each outstanding stock option will become immediately vested in the event of the death or disability of the optionee or upon a change-in-control of Norwood.

#### Director Compensation

Set forth below is a table providing information concerning the compensation of the directors of Norwood Financial Corp. who are not Named Executive Officers for the last completed fiscal year (2009).

Name	Fees Earned or Paid in Cash	Stock Awards	Option Awards(1)	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation(2)	Total
John E. Marshall	\$ 28,200	--	\$ 3,385	--	--	\$ 567	\$ 32,152
Kenneth A. Phillips	26,400	--	3,385	--	--	180	29,965
Ralph A. Matergia	28,500	--	3,385	--	--	229	32,114
Richard L. Snyder	28,200	--	3,385	--	--	--	31,585
Gary P. Rickard	27,000	--	3,385	--	--	444	30,829
Daniel J. O'Neill	27,300	--	3,385	--	--	508	31,193
Dr. Andrew A. Forte	26,700	--	3,385	--	--	120	30,205
Susan Gumble-Cottell	27,000	--	3,385	--	--	120	30,505

(1)Based on the aggregate grant date fair value of the award computed in accordance with FASB ASC Topic 718. For assumptions used, see Note 13 of Notes to Consolidated Financial Statements. The grant-date fair value of the options awarded to Directors in December 2009 was \$6.77 each. At December 31, 2009, Directors had the following number of stock option awards outstanding:

Name	Number of Options
------	----------------------

John E. Marshall	2,000
Kenneth A. Phillips	4,514
Ralph A. Matergia	2,525
Richard L. Snyder	4,514
Gary P. Rickard	2,525
Daniel J. O'Neill	2,525
Dr. Andrew A. Forte	1,500
S u s a n Gumble-Cottell	2,000

(2) Consists of the value of life insurance premiums paid by Norwood for the benefit of the director.

Norwood does not presently compensate its directors. Each director of Norwood is also a director of Wayne Bank and receives fees accordingly. Mr. William W. Davis, Jr., President and Chief Executive Officer of Norwood and Wayne Bank and Lewis J. Critelli, Executive Vice President, Chief Financial Officer and Secretary, did not receive board or committee fees for their participation thereon. Each non-employee member of Wayne Bank's Board of Directors receives a retainer of \$1,950 per month. In addition, fees are paid for various committee meetings as follows: Trust Committee (\$300); Audit Committee (\$300); Compensation Committee (\$300); and Loan Committee (\$300). For the fiscal year ended December 31, 2009, fees paid to all directors totaled approximately \$219,300, all of which were paid by Wayne Bank. Norwood pays for life insurance coverage of \$50,000 for each director.

Under the 2006 Stock Option Plan, stock options for 525 shares each were awarded to non-employee directors effective upon shareholder approval of the plan for 2005 and options for 500 shares were awarded on December 29, 2006. Options for 500 shares were awarded to each non-employee director effective as of December 31, 2007, 2008 and 2009, respectively. The exercise price of these options was in each case equal to the fair market value of the underlying Common Stock on the effective date of grant. In each case, the options vest and become exercisable one year from the date of grant. Additional options may be granted to non-employee directors on an annual basis on a date established by the Compensation Committee.

#### Related Party Transactions

Certain directors and executive officers of Wayne Bank, their families and their affiliates are customers of Wayne Bank. Any transactions with such parties including loans and commitments are made on substantially the same terms and conditions, including interest rate and collateral, as those of comparable transactions prevailing at the time with other persons, and do not include more than the normal risk of collectibility or present other unfavorable features. Wayne Bank has adopted written policies and procedures for the approval of loans to directors and executive officers. All loans to directors and executive officers are approved by the entire Board of Directors in advance with the director or executive officer abstaining from participating directly or indirectly in the voting.

#### SECURITY OWNERSHIP OF DIRECTORS, EXECUTIVE OFFICERS AND CERTAIN BENEFICIAL OWNERS

Under the rules of the SEC, a person is deemed to be a "beneficial owner" of a security if that person has or shares "voting power," which includes the power to vote or to direct the voting of the security, or "investment power," which includes the power to dispose of or to direct the disposition of the security. The rules also treat as outstanding all shares of common stock that a person would receive upon exercise of stock options or warrants held by that person, which are immediately exercisable or exercisable within 60 days of the beneficial ownership determination date. Under these rules, more than one person may be deemed a beneficial owner of the same securities and a person may be deemed to be a beneficial owner of securities as to which that person has no economic interest.

#### Norwood

The following table indicates the common stock beneficially by Norwood's executive officers and directors, by each person known by Norwood to own beneficially more than 5% of Norwood common stock, and all of Norwood's executive officers and directors as a group. Unless otherwise noted, all shares are held directly by the director or executive officer and the director or executive officer has sole voting and investment power with respect such shares. The address for each director and officer is Wayne Bank, 717 Main Street, Honesdale, Pennsylvania 18431. All amounts are determined as of \_\_\_\_\_, 2011 when there were \_\_\_\_\_ shares of Norwood common stock issued outstanding.



Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Shares of Common Stock Outstanding
Wayne Bank Trust Department 717 Main Street Honesdale, Pennsylvania 18431	(1)	%
Lewis J. Critelli William W. Davis, Jr. Richard L. Snyder Ralph A. Matergia Dr. Andrew A. Forte Daniel J. O'Neill Dr. Kenneth A. Phillips John E. Marshall Susan Gumble-Cottell Edward C. Kasper Kenneth C. Doolittle Joseph A. Kneller John H. Sanders William S. Lance		
All Directors and Executive Officers as a group (___ persons)		

(1) The Wayne Bank Trust Department has sole voting and dispositive power over 216,062 shares. Excludes 223,108 shares held in two trusts for which Wayne Bank acts as trustee but as to which it does not have voting power.

## North Penn

The following table provides information as of January 31, 2011 about the persons known to North Penn to be the beneficial owners of more than 5% of North Penn's outstanding common stock. A person may be considered to beneficially own any shares of common stock over which he or she has, directly or indirectly, sole or shared voting or investment power.

Name and Address	Number of Shares Beneficially Owned	Percent of Outstanding Common Stock Beneficially Owned
North Penn Bank Employee Stock Ownership Plan 216 Adams Avenue Scranton, Pennsylvania 18503	124,794	9.4%
Kevin M. Lamont 216 Adams Avenue Scranton, Pennsylvania 18503	103,756	7.8%
Frederick L. Hickman 216 Adams Avenue Scranton, Pennsylvania 18503	102,463	7.6%
Philip V. Oppenheimer Carl K. Oppenheimer 119 West 57th Street, Suite 1515 New York, NY 10019	82,665(2)	6.2%

(2)Based on information filed in Schedule 13G with the Securities and Exchange Commission on March 18, 2010 and included shares held by each of P. Oppenheimer Investment Partnership, L.P., Oppenheimer-Spence Financial Services Partnership L.P., Oppenheimer-Close International, Ltd., Oppvest II, LLC and Oppvest, LLC.

The following table provides information as of January 31, 2011 about the shares of North Penn common stock that may be considered to be beneficially owned by each director, each executive officer named in the summary compensation table contained in North Penn's most recent annual meeting proxy statement and all directors and executive officers of North Penn as a group. A person may be considered to beneficially own any shares of common stock over which he or she has, directly or indirectly, sole or shared voting or investment power. Unless otherwise indicated, each of the named individuals has sole voting power and sole investment power with respect to the number of shares shown.



Name of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)		Number of Shares That May be Acquired Within 60 Days by Exercising Options	Percent of Class(2)
Thomas A. Byrne	16,337	(3)	6,885	1.7%
Thomas J. Dziak	15,969	(4)	8,549	1.8%
Gordon S. Florey	3,263	(5)	294	*
Frederick L. Hickman	82,035	(6)	20,428	7.6%
Herbert C. Kneller	2,942	(7)	299	*
Virginia D. McGregor	5,562	(8)	536	*
Frank H. Mechler	6,977	(9)	439	*
Kevin M. Lamont	98,578	(10)	5,178	7.8%
James W. Reid	3,453	(11)	296	*
Executive Officers and Directors as a group (10 persons)	236,366		44,404	20.4%

\* Less than 1%.

(1) Excludes shares that may be acquired upon the exercise of stock options.

(2) Based on 1,332,660 shares of North Penn common stock outstanding and entitled to vote as of January 31, 2011, plus, for each person, the number of shares that such person may acquire within 60 days by exercising stock options.

(3) Includes 2,879 shares owned by Mr. Byrne held in 401(k) Plan, 3,649 shares owned by Mr. Byrne held in ESOP, 2,778 shares owned by spouse's IRA and 4,214 shares of unvested stock.

(4) Includes 2,010 shares owned by Mr. Dziak held in 401(k) Plan, 3,451 shares owned by Mr. Dziak held in ESOP, 5,418 shares held by Mr. Dziak in an IRA and 2,508 shares of unvested restricted stock.

(5) Includes 2,000 shares owned by Mr. Florey held in IRA and 1,109 shares of unvested restricted stock.

(6) Includes 14,720 shares owned by Mr. Hickman held in 401(k) Plan, 6,399 shares owned by Mr. Hickman held in ESOP, 109 shares owned by Mr. Hickman's wife, 109 shares held by Mr. Hickman as custodian for his son and 109 shares held by Mr. Hickman as custodian for his daughter and 19,739 shares of unvested restricted stock.

(7) Includes 1,093 shares of unvested restricted stock.

(8) Includes 1,224 shares of unvested restricted stock.

(9) Includes 5,460 shares owned by Mr. Mechler as trustee for Judith Mechler Trust and 1,285 shares of unvested restricted stock.

(10) Includes 9,478 shares of unvested restricted stock.

(11) Includes 1,117 shares of unvested restricted stock.

## Equity Compensation Plan Information

Norwood. The following table sets forth information as of December 31, 2010 regarding compensation plans under which equity securities of Norwood are authorized for issuance.

	(a)	(b)	(c)
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans, (excluding securities reflected in column (a))
Equity compensation plans approved by security holders			
Stock Option Plan	41,986	\$	
2006 Stock Option Plan	143,675		
Equity compensation plans not approved by security holders			
1999 Directors Stock Compensation Plan	3,978		
TOTAL	189,639	\$	

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

North Penn. The following table sets forth information as of December 31, 2010 regarding compensation plans under which equity securities of North Penn are authorized for issuance.

	(a)	(b)	(c)
	Number of Securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans, (excluding securities reflected in column (a))
Equity compensation plans	157,246	9.28	0

approved by security holders

Equity compensation plans

not

approved by security holders

TOTAL	157,246	\$	9.28	0
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### ADJOURNMENT OF THE SPECIAL MEETING

In the event that there are not sufficient votes to constitute a quorum or approve the adoption of the merger agreement at the time of the special meeting, the merger agreement may not be adopted unless the special meeting is adjourned to a later date or dates in order to permit further solicitation of proxies. In order to allow proxies that have been received by North Penn at the time of the special meeting to be voted for an adjournment, if necessary, North Penn has submitted the proposal on adjournment to its shareholders as a separate matter for their consideration. The board of directors of North Penn unanimously recommends that stockholders vote "FOR" the adjournment proposal. If it is necessary to adjourn the special meeting, no notice of the adjourned special meeting is required to be given to shareholders (unless the adjournment is for more than 30 days or if a new record date is fixed), other than an announcement at the special meeting of the hour, date and place to which the special meeting is adjourned.

### EXPERTS

The report dated March 9, 2010, with respect to the consolidated statement of condition of Norwood and subsidiary as of December 31, 2009, and the related consolidated statement of income, comprehensive income, changes in stockholders' equity, and cash flows for the year ended December 31, 2009, included herein, has been included in reliance upon the reports of S.R. Snodgrass, A.C., an independent registered public accounting firm, and upon the authority of said firm as experts in accounting and auditing. The report dated March 10, 2009, with respect to the consolidated statement of condition of Norwood as of December 31, 2008 and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years in the two-year period ended December 31, 2008 included herein have been included in reliance on the report of ParenteBeard LLC, an independent registered public accounting firm and upon the authority of said firm as experts in accounting and auditing.

On August 11, 2009, Norwood dismissed Beard Miller Company LLP ("BMC") as Norwood's independent public accountants, and engaged S.R. Snodgrass, A.C. to serve as Norwood's independent public accountants. The appointment of Snodgrass and the dismissal of BMC were approved by the Audit Committee of Norwood's Board of Directors. BMC performed audits of Norwood's consolidated financial statements for the years ended December 31, 2008 and 2007. BMC's reports did not contain an adverse opinion or disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope or accounting principles. During the two years ended December 31, 2008 and from December 31, 2008 through August 11, 2009, there were no disagreements or reportable events between Norwood and BMC on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to the satisfaction of BMC, would have caused them to make a reference to the subject matter of the disagreements or reportable events in connection with their reports.

The financial statements of North Penn Bancorp, Inc. and its subsidiaries included in this proxy statement/prospectus for the year ended December 31, 2009 have been so included in reliance on the report of J. H. Williams Co., LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting. The financial statements of North Penn Bancorp, Inc. and its subsidiaries included in this proxy statement/prospectus for the year ended December 31, 2008 have been so included in reliance on the report of McGrail Merkel Quinn & Associates, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

On August 13, 2009, McGrail Merkel Quinn & Associates resigned as North Penn's independent registered public accounting firm. McGrail Merkel Quinn & Associates' report on North Penn's consolidated financial statements for the two fiscal years ended December 31, 2008 and 2007 did not contain an adverse opinion or disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or accounting principles.

During the fiscal years ended December 31, 2008 and 2007, as well as the interim period preceding the resignation of McGrail Merkel Quinn & Associates, there were no disagreements or reportable events of the kind described in Item 304(a)(1)(v) of Regulation S-K of the Securities and Exchange Commission between North Penn and McGrail Merkel Quinn & Associates on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedure which, if not resolved to the satisfaction of McGrail Merkel Quinn & Associates, would have caused McGrail Merkel Quinn & Associates to make a reference to the subject matter of the disagreement or reportable event in connection with the issuance of its audit reports.

#### LEGAL OPINIONS

Malizia Spidi & Fisch, PC and Kilpatrick Townsend & Stockton LLP will deliver prior to the effective time of the merger their opinions to Norwood and North Penn, respectively, as to certain United States federal income tax consequences of the merger. See "The Merger and the Merger Agreement -- Tax Consequences of the Merger" on page 56. In addition, Malizia Spidi & Fisch, PC has given its opinion with respect to the validity of the shares of Norwood common stock to be issued in the merger.

#### OTHER MATTERS

As of the date of this proxy statement/prospectus, the Norwood board of directors does not know of any matters that will be presented for consideration at its special meeting other than as described in this document. However, if any other matter shall properly come before the special meeting or any adjournment or postponement thereof and shall be voted upon, the proposed proxies will be deemed to confer authority to the individuals named as authorized therein to vote the shares represented by the proxy as to any matters that fall within the purposes set forth in the notices of special meetings.

#### NORTH PENN ANNUAL MEETING SHAREHOLDER PROPOSALS

If the merger is completed, North Penn will no longer have a separate corporate existence or any shareholders. However, if the merger is not completed or if North Penn is otherwise required to do so under applicable law, North Penn will hold a 2011 annual meeting of shareholders. Any shareholder nominations or proposals for other business intended to be presented at North Penn's next annual meeting must be submitted to North Penn as set forth below.

Under North Penn's bylaws certain procedures are provided that a shareholder must follow to nominate persons for election as directors or to introduce an item of business at an annual meeting of shareholders. These procedures provide that nominations for director nominees and/or an item of business to be introduced at an annual meeting of shareholders must be submitted in writing to the Corporate Secretary of North Penn at 216 Adams Avenue, Scranton, Pennsylvania 18503 no later than 60 days prior to the anniversary date of the 2010 annual meeting.

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## NORWOOD FINANCIAL CORP.

## CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2010	December 31, 2009
	(In Thousands, Except Share Data)	
<b>ASSETS</b>		
Cash and due from banks	\$ 9,057	\$ 6,498
Interest bearing deposits with banks	7,696	7,857
Federal funds sold	3,000	3,000
Cash and cash equivalents	19,753	17,355
Securities available for sale	139,308	130,577
Securities held to maturity, fair value 2010 \$177, 2009 \$722	169	708
Loans receivable (net of unearned income)	358,354	363,474
Less: Allowance for loan losses	5,513	5,453
Net loans receivable	352,841	358,021
Investment in Federal Home Loan Bank stock, at cost	3,538	3,538
Bank premises and equipment, net	5,012	5,189
Bank owned life insurance	8,161	7,889
Accrued interest receivable	2,342	2,200
Foreclosed real estate owned	748	392
Other assets	2,685	3,827
Total Assets	\$ 534,557	\$ 529,696
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities		
Deposits:		
Non-interest bearing demand	\$ 66,331	\$ 59,820
Interest-bearing	332,321	331,653
Total deposits	398,652	391,473
Short-term borrowings	24,530	25,803
Other borrowings	38,000	43,000
Accrued interest payable	1,652	2,057
Other liabilities	3,280	2,892
Total Liabilities	466,114	465,225
Stockholders' Equity		
Common stock, \$.10 par value per share, authorized 10,000,000; shares issued 2,840,872	284	284
Surplus	9,815	9,764
Retained earnings	57,642	54,455
Treasury stock, at cost: 2010: 79,977 shares, 2009: 68,436	(2,437)	(2,122)
Accumulated other comprehensive income	3,139	2,090
Total Stockholders' Equity	68,443	64,471
Total Liabilities and Stockholders' Equity	\$ 534,557	\$ 529,696

See accompanying notes to the unaudited consolidated financial statements.

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## NORWOOD FINANCIAL CORP.

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Nine Months Ended September 30,	
	2010	2009
	(In Thousands, Except Per Share Data)	
<b>INTEREST INCOME</b>		
Loans receivable, including fees	\$ 15,894	\$ 16,095
Securities	3,477	4,010
Other	43	8
Total Interest Income	19,414	20,113
<b>INTEREST EXPENSE</b>		
Deposits	3,332	4,354
Short-term borrowings	87	229
Other borrowings	1,247	1,248
Total Interest Expense	4,666	5,831
Net Interest Income	14,748	14,282
<b>PROVISION FOR LOAN LOSSES</b>		
Net Interest Income After Provision for Loan Losses	14,018	13,697
<b>OTHER INCOME</b>		
Service charges and fees	1,680	1,854
Income from fiduciary activities	300	263
Net realized gains on sales of securities	380	423
Gain on sale of loans and servicing rights	208	296
Gain on sale of deposits	-	150
Other	485	481
Total Other Income	3,053	3,467
<b>OTHER EXPENSES</b>		
Salaries and employee benefits	4,844	4,820
Occupancy, furniture & equipment, net	1,190	1,231
Data processing related operations	607	593
Taxes, other than income	374	414
Professional fees	358	302
Federal Deposit Insurance Corporation insurance assessment	357	617
Foreclosed real estate owned	32	148
Other	1,686	1,644
Total Other Expenses	9,448	9,769
Income before Income Taxes	7,623	7,395
<b>INCOME TAX EXPENSE</b>		
Net Income	\$ 5,505	\$ 5,261

EARNINGS PER SHARE

BASIC	\$	1.99	\$	1.92
DILUTED	\$	1.99	\$	1.90

See accompanying notes to the unaudited consolidated financial statements.

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## NORWOOD FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)  
Nine months ended September 30, 2010

	Common Stock		Retained		Treasury Stock		Accumulated Other Comprehensive	Total
	Shares	Amount	Surplus	Earnings	Shares	Amount	Income	
	(Dollars in Thousands, Except Per Share Data)							
BALANCE DECEMBER 31, 2009	2,840,872	\$ 284	\$ 9,764	\$ 54,455	68,436	\$ (2,122)	\$ 2,090	\$ 64,471
Comprehensive Income:								
Net Income				5,505				5,505
Change in unrealized gains on securities available for sale, net of reclassification adjustments and tax effects							1,049	1,049
Total comprehensive income								6,554
Cash dividends declared \$.84 per share				(2,318)				(2,318)
Acquisition of treasury stock					18,571	(529)		(529)
Stock options exercised			(103)		(7,030)	214		111
Tax benefit on stock options exercised			32					32
Compensation expense related to stock options			122					122
BALANCE, SEPTEMBER 30, 2010	2,840,872	\$ 284	\$ 9,815	\$ 57,642	\$ 79,977	\$ (2,437)	\$ 3,139	\$ 68,443

See accompanying notes to the unaudited consolidated financial statements.

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## NORWOOD FINANCIAL CORP.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30,	
	2010	2009
	(In Thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$ 5,505	\$ 5,261
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	730	585
Depreciation	347	422
Amortization of intangible assets	39	39
Deferred income taxes	(36)	779
Net amortization of securities premiums and discounts	273	102
Net realized gain on sales of securities	(380)	(423)
Gain on sale of deposits	-	(150)
Increase in investment in life insurance	(270)	(261)
Loss (gain) on sale of bank premises and equipment and foreclosed real estate	(3)	118
Gain on sale of mortgage loans and servicing rights	(208)	(296)
Mortgage loans originated for sale	(10,537)	(21,565)
Proceeds from sale of mortgage loans originated for sale	10,745	21,861
Compensation expense related to stock options	122	98
Decrease (increase) in accrued interest receivable and other assets	569	(653)
Increase (decrease) in accrued interest payable and other liabilities	(14)	862
Net cash provided by operating activities	6,882	6,779
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Securities available for sale:		
Proceeds from sales	23,778	13,586
Proceeds from maturities and principal reductions on mortgage-backed securities	51,704	34,456
Purchases	(82,518)	(41,854)
Securities held to maturity, proceeds from maturities	540	-
Net (increase) decrease in loans	3,886	(10,446)
Purchase of bank premises and equipment	(175)	(193)
Proceeds from sale of bank premises and equipment and foreclosed real estate	100	121
Net cash used in investing activities	(2,685)	(4,330)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	7,179	26,984
Deposits sold	-	(3,606)
Net decrease in short-term borrowings	(1,274)	(18,573)
Repayment of long-term debt	(5,000)	-
Stock options exercised	111	457
Tax benefit of stock options exercised	32	146
Purchase of treasury stock	(529)	(68)
Cash dividends paid	(2,318)	(2,220)
Net cash provided by (used in) financing activities	(1,799)	3,120

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Increase in cash and cash equivalents	2,398	5,569
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	17,355	6,480
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 19,753	\$ 12,049

See accompanying notes to the unaudited consolidated financial statements.

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## NORWOOD FINANCIAL CORP.

## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 - BASIS OF PRESENTATION

The unaudited 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., Norwood Investment Corp. and WTRO Properties. All significant intercompany transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in conformity with generally accepted accounting principles for interim financial statements and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. 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 and results of operations of the Company. The operating results for the nine month period ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010 or any other future interim period.

These statements should be read in conjunction with the consolidated financial statements and related notes which are incorporated by reference in the Company's Annual Report on Form 10-K for the year-ended December 31, 2009.

## NOTE 2 - EARNINGS PER SHARE

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

The following table sets forth the weighted average shares outstanding used in the computations of basic and diluted earnings per share:

	Nine Months Ended September 30,	
	2010	2009
	(In Thousands)	
Basic EPS weighted average shares outstanding	2,762	2,745
Dilutive effect of stock options	5	18
Diluted EPS weighted average shares outstanding	2,767	2,763

Stock options which had no intrinsic value, because their effect would be anti-dilutive and therefore would not be included in the diluted EPS calculation were 113,150 and 103,000 as of September 30, 2010 and 2009, respectively based upon the closing price of Norwood stock on September 30, 2010 of \$28.00 per share.

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## NORWOOD FINANCIAL CORP.

## NOTE 3 - STOCK-BASED COMPENSATION

The Company's shareholders approved the Norwood Financial Corp 2006 Stock Option Plan at the annual meeting on April 25, 2006 and the Company awarded 47,700 options in 2006, 22,000 options in 2007, 24,000 options in 2008, 27,000 options in 2009 and 1,000 options in 2010, all of which have a twelve month vesting period. As of September 30, 2010, there was \$41,000 of total unrecognized compensation cost related to non-vested options granted in 2009 and 2010 under the plan, which will be fully amortized by December 31, 2010.

A summary of stock options from all plans, adjusted for stock dividends declared, is shown below.

	Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2010	170,915	\$ 28.07	6.8 Yrs.	\$ 286
Granted	1,000	26.88	9.7 Yrs.	1
Exercised	(7,030)	15.94	1.3 Yrs.	80
Outstanding at September 30, 2010	164,885	\$ 28.57	6.2 Yrs.	\$ 169
Exercisable at September 30, 2010	140,885	\$ 28.37	4.8 Yrs.	\$ 168

Intrinsic value represents the amount by which the market price of the stock on the measurement date exceeded the exercise price of the option. The stock price was \$28.00 as of September 30, 2010 and \$28.59 as of December 31, 2009. The intrinsic value of options exercised during the nine months ended September 30, 2010 was \$80,000, cash received from such exercises was \$111,000 and the tax benefit recognized was \$32,000.

## NOTE 4 - CASH FLOW INFORMATION

For the purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks all of which mature within 90 days and federal funds sold.

Cash payments for interest for the nine months ended September 30, 2010 and 2009 were \$5,071,000 and \$5,713,000, respectively. Cash payments for income taxes for the periods ending September 30, 2010 and 2009 were \$1,990,000 and \$1,838,000, respectively. Non-cash investing activity for 2010 and 2009 included repossession of other assets and foreclosed mortgage loans transferred to real estate owned of \$564,000 and \$213,000, respectively.

## NOTE 5 - COMPREHENSIVE INCOME

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

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## NORWOOD FINANCIAL CORP.

## NOTE 5 - COMPREHENSIVE INCOME (CONTINUED)

	Nine Months Ended September 30,	
	2010	2009
	(In Thousands)	
Unrealized holding gains on available for sale securities	\$ 1,970	\$ 2,522
Reclassification adjustment for gains realized in income	(380)	(423)
Net unrealized gains	1,590	2,099
Income tax expense	541	718
Other comprehensive income	\$ 1,049	\$ 1,381

## NOTE 6 - OFF-BALANCE SHEET FINANCIAL INSTRUMENTS AND GUARANTEES

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

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

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

	September 30,	
	2010	2009
	(In Thousands)	
Commitments to grant loans	\$ 19,867	\$ 11,686
Unfunded commitments under lines of credit	30,992	35,117
Standby letters of credit	3,195	2,060
	\$ 54,054	\$ 48,863

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

The Bank does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Bank, generally, holds collateral and/or personal guarantees supporting

these commitments. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of September 30, 2010 for guarantees under standby letters of credit issued is not material.

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## NORWOOD FINANCIAL CORP.

## NOTE 7 - SECURITIES

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

	September 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
Available for Sale:				
U.S. Government agencies	\$ 30,196	\$ 526	\$ -	\$ 30,722
States and political subdivisions	46,802	1,944	-	48,746
Corporate obligations	4,025	281	-	4,306
Mortgage-backed securities	53,200	1,663	(74)	54,789
	134,223	4,414	(74)	138,563
Equity securities	324	425	(4)	745
	\$ 134,547	\$ 4,839	\$ (78)	\$ 139,308
Held to Maturity:				
States and political subdivisions	\$ 169	\$ 8	\$ -	\$ 177

	December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
Available for Sale:				
U.S. Government agencies	\$ 39,607	\$ 295	\$ (130)	\$ 39,772
States and political subdivisions	30,872	780	(17)	31,635
Corporate obligations	5,043	200	(3)	5,240
Mortgage-backed securities	51,554	1,618	(18)	53,154
	127,076	2,893	(168)	129,801
Equity securities	330	451	(5)	776
	\$ 127,406	\$ 3,344	\$ (173)	\$ 130,577
Held to Maturity:				
States and political subdivisions	\$ 708	\$ 14	\$ -	\$ 722

## NORWOOD FINANCIAL CORP.

## NOTE 7 – SECURITIES (CONTINUED)

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

	Less than 12 Months		September 30, 2010 12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
U.S. Government agencies States and political subdivisions	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Mortgage-backed securities	11,751	(74)	-	-	11,751	(74)
Equity securities	50	(2)	5	(2)	55	(4)
	\$ 11,801	\$ (76)	\$ 5	\$ (2)	\$ 11,806	\$ (78)

The Company has five securities in an unrealized loss position in the less than twelve months category and no securities in the twelve months or more category. In Management's opinion the unrealized losses less than twelve months on mortgage-backed securities principally reflect changes in interest rates subsequent to the acquisition of specific securities. The Company holds a small amount of equity securities in other financial institutions. The value of these equity securities has been impacted by the overall weakness in the financial sector, one of which has been in a loss position for greater than one year and two which has been in a loss position for less than twelve months. During the fourth quarter of 2009, the Company recorded an other-than-temporary impairment charge on two equity holdings totaling \$31,000. Management believes that all other unrealized losses represent temporary impairment of the securities as the Company does not have the intent to sell these securities and it is more likely than not that it will not have to sell the securities before recovery of their cost basis.

	Less than 12 Months		December 31, 2009 12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
U.S. Government agencies States and political subdivisions	\$ 15,366	\$ (130)	\$ -	\$ -	\$ 15,366	\$ (130)
Corporate obligations	1,413	(17)	-	-	1,413	(17)
Mortgage-backed securities	997	(3)	-	-	997	(3)
Equity securities	3,655	(18)	-	-	3,655	(18)
	49	(3)	5	(2)	54	(5)
	\$ 21,480	\$ (171)	\$ 5	\$ (2)	\$ 21,485	\$ (173)



## NORWOOD FINANCIAL CORP.

## NOTE 7 – SECURITIES (CONTINUED)

The amortized cost and fair value of debt securities as of September 30, 2010 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
		(In Thousands)		
Due in one year or less	\$ 1,006	\$ 1,020	\$ -	\$ -
Due after one year through five years	33,279	34,159	169	177
Due after five years through ten years	19,225	19,992	-	-
Due after ten years	27,513	28,603	-	-
	81,023	83,774	169	177
Mortgage-backed securities	53,200	54,789	-	-
	\$ 134,223	\$ 138,563	\$ 169	\$ 177

Gross realized gains and gross realized losses on sales of securities available for sale were as follows:

	Nine Months Ended September 30,	
	2010	2009
		(In Thousands)
Gross realized gains	\$ 380	\$ 526
Gross realized losses	-	(103)
Net realized gain	\$ 380	\$ 423
Proceeds from sales of securities	\$ 23,778	\$ 13,586

## NOTE 8 - FAIR VALUE MEASUREMENTS

Generally accepted accounting principles in the United States of America established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.
- Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.



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## NORWOOD FINANCIAL CORP.

## NOTE 8 - FAIR VALUE MEASUREMENTS (CONTINUED)

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2010 and December 31, 2009 are as follows:

Description	Total (In Thousands)	Fair Value Measurement Reporting Date Using		
		(Level 1) Quoted Prices in Active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
September 30, 2010				
Available for Sale:				
US Government agencies	\$ 30,722	\$ -	\$ 30,722	\$ -
States and political subdivisions	48,746	-	48,746	-
Corporate securities	4,306	-	4,306	-
Mortgage-backed securities	54,789	-	54,789	-
Equity securities	745	745	-	-
Total available for sale	139,308	745	138,563	-
Mortgage servicing rights	247	-	-	247
Total	\$ 139,555	\$ 745	\$ 138,563	\$ 247
December 31, 2009				
Available for Sale:				
US Government agencies	\$ 39,772	\$ -	\$ 39,772	\$ -
States and political subdivisions	31,635	-	31,635	-
Corporate securities	5,240	-	5,240	-
Mortgage-backed securities	53,154	-	53,154	-
Equity securities	776	776	-	-
Total available for sale	130,577	776	129,801	-
Mortgage servicing rights	179	-	-	179
Total	\$ 130,756	\$ 776	\$ 129,801	\$ 179

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2010 and December 31, 2009 are as follows:

Description	Total	Fair Value Measurement Reporting Date Using		
		(Level 1) Quoted Price in Active Markets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs

For  
Identical  
Assets

(In Thousands)

September 30, 2010								
Impaired Loans	\$	13,343	\$	-	\$	13,343	\$	-
Foreclosed Real Estate Owned		748		-		748		-
	\$	14,091	\$	-	\$	14,091	\$	-
December 31, 2009								
Impaired Loans	\$	7,991	\$	-	\$	7,991	\$	-
Foreclosed Real Estate Owned		392		-		392		-
	\$	8,383	\$	-	\$	8,383	\$	-

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NORWOOD FINANCIAL CORP.

NOTE 8 - FAIR VALUE MEASUREMENTS (CONTINUED)

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at September 30, 2010 and December 31, 2009.

Cash and cash equivalents (carried at cost):

The carrying amounts reported in the consolidated balance sheet for cash and short-term instruments approximate those assets' fair values.

Securities:

The fair value of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 2). Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain (Level 3) investments, if applicable.

Loans receivable (Carried at cost):

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

The Company measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as either Level 2 or Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

As of September 30, 2010, the fair value investment in impaired loans totaled \$13,343,000 which includes four loans for \$8.8 million for which a valuation allowance has been provided based on current collateral values and four loans for \$4.5 million which do not require a valuation allowance since the current collateral value exceeds the loan value. As of September 30, 2010, the Company has recognized charge-offs against the allowance for loan losses on impaired loans in the amount of \$690,000 over the life of the loans.

As of December 31, 2009, the fair value investment in impaired loans was \$7,991,000 which included two loans for \$1.0 million for which a valuation allowance had been provided based on the estimated value of the collateral and five loans for \$7.0 million which did not require a valuation allowance since the estimated realizable value of the collateral exceeded the recorded investment in the loan. As of December 31, 2009, the Company had recognized a cumulative charge-off against the allowance for loans losses in the amount of \$634,000 on impaired loans.



## NORWOOD FINANCIAL CORP.

## NOTE 8 - FAIR VALUE MEASUREMENTS (CONTINUED)

	September 30, 2010		
	Carrying Value	Valuation Allowance (In Thousands)	Cumulative Charge-offs Recognized
Impaired loans requiring a valuation allowance	\$ 8,827	\$ 1,268	\$ 480
Impaired loans not requiring a valuation allowance	4,516	-	210
Total	\$ 13,343	\$ 1,268	\$ 690
	December 31, 2009		
	Carrying Value	Valuation Allowance (In Thousands)	Cumulative Charge-offs Recognized
Impaired loans requiring a valuation allowance	\$ 1,029	\$ 36	\$ 480
Impaired loans not requiring a valuation allowance	6,962	-	154
Total	\$ 7,991	\$ 36	\$ 634

## Foreclosed real estate owned

Real estate properties acquired through, or in lieu of loan foreclosure are to be sold and are carried at fair value less cost to sell. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. These assets are included in Level 2 fair value based upon the lowest level of input that is significant to the fair value measurement.

## Restricted investment in Federal Home Loan Bank stock (carried at cost):

Restricted stock which represents required investment in the common stock of correspondent banks is carried at cost and as of September 30, 2010 and December 31, 2009, consists of the common stock of the Federal Home Loan Bank of Pittsburgh. In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of excess capital stock.

Management evaluates the restricted stock for impairment. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB. Management believes no impairment charge is necessary related to FHLB stock as of September 30, 2010.

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## NORWOOD FINANCIAL CORP.

## NOTE 8 - FAIR VALUE MEASUREMENTS (CONTINUED)

Accrued interest receivable and payable (carried at cost):

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Deposit liabilities (carried at cost):

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term borrowings (carried at cost):

The carrying amounts of short-term borrowings approximate their fair values.

Other borrowings (carried at cost):

Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Off-balance sheet financial instruments (disclosed at cost):

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

The estimated fair values of the Bank's financial instruments were as follows at September 30, 2010 and December 31, 2009.

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In Thousands)			
Financial assets:				
Cash and due from banks, interest-bearing deposits with banks and federal funds sold	\$ 19,753	\$ 19,753	\$ 17,355	\$ 17,355
Securities	139,477	139,485	131,285	131,299
Loans receivable, net	352,841	366,940	358,021	368,180
Investment in FHLB stock	3,538	3,538	3,538	3,538
Accrued interest receivable	2,342	2,342	2,200	2,200
Financial liabilities:				
Deposits	398,652	400,109	391,473	392,445
Short-term borrowings	24,530	24,530	25,803	25,803
Other borrowings	38,000	40,998	43,000	45,591
Accrued interest payable	1,652	1,652	2,057	2,057



Off-balance sheet financial instruments:

Commitments to extend credit  
and outstanding  
letters of credit

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NORWOOD FINANCIAL CORP.

NOTE 9 - NEW AND RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In December 2009, the FASB issued ASU 2009-16, Accounting for Transfer of Financial Assets. ASU 2009-16 provides guidance to improve the relevance, representational faithfulness, and comparability of the information that an entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. ASU 2009-16 is effective for annual periods beginning after November 15, 2009 and for interim periods within those fiscal years. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In January 2010, the FASB issued ASU 2010-01, Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash – a consensus of the FASB Emerging Issues Task Force. ASU 2010-01 clarifies that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend. ASU 2010-01 is effective for interim and annual periods ending on or after December 15, 2009 and should be applied on a retrospective basis. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In January 2010, the FASB issued ASU 2010-05, Compensation – Stock Compensation (Topic 718): Escrowed Share Arrangements and the Presumption of Compensation. ASU 2010-05 updates existing guidance to address the SEC staff's views on overcoming the presumption that for certain shareholders escrowed share arrangements represent compensation. ASU 2010-05 is effective January 15, 2010. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company has presented the necessary disclosures in Note 8 herein.

In February 2010, the FASB issued ASU 2010-08, Technical Corrections to Various Topics. ASU 2010-08 clarifies guidance on embedded derivatives and hedging. ASU 2010-08 is effective for interim and annual periods beginning after December 15, 2009. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In March 2010, the FASB issued ASU 2010-11, Derivatives and Hedging. ASU 2010-11 provides clarification and related additional examples to improve financial reporting by resolving potential ambiguity about the breadth of the embedded credit derivative scope exception in ASC 815-15-15-8. ASU 2010-11 is effective at the beginning of the first fiscal quarter beginning after June 15, 2010. The adoption of this guidance did not have a significant impact on the Company's financial statements.

In April 2010, the FASB issued ASU 2010-18, Receivables (Topic 310): Effect of a Loan Modification When the Loan is a Part of a Pool That is Accounted for as a Single Asset – a consensus of the FASB Emerging Issues Task Force. ASU 2010-18 clarifies the treatment for a modified loan that was acquired as part of a pool of

assets. Refinancing or restructuring the loan does not make it eligible for removal from the pool, the FASB said. The amendment will be effective for loans that are part of an asset pool and are modified during financial reporting periods that end July 15, 2010 or later and did not have a significant impact on the Company's financial statements.

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NORWOOD FINANCIAL CORP.

NOTE 9 - NEW AND RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS (CONTINUED)

In July 2010, FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. ASU 2010-20 is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The amendments in ASU 2010-20 encourage, but do not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption. The Company is currently evaluating the impact the adoption of this guidance will have on the Company's financial position or results of operations.

In August, 2010, the FASB issued ASU 2010-21, Accounting for Technical Amendments to Various SEC Rules and Schedules. This ASU amends various SEC paragraphs pursuant to the issuance of Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules, and Codification of Financial Reporting Policies and is not expected to have a significant impact on the Company's financial statements.

In August, 2010, the FASB issued ASU 2010-22, Technical Corrections to SEC Paragraphs – An announcement made by the staff of the U.S. Securities and Exchange Commission. This ASU amends various SEC paragraphs based on external comments received and the issuance of SAB 112, which amends or rescinds portions of certain SAB topics and is not expected to have a significant impact

NOTE 10 - BRANCH CLOSURE

On December 26, 2008, the Company filed notifications with the Pennsylvania Department of Banking and the FDIC, requesting authorization to discontinue branch operations at its Hamlin Office, as the lease for the location expired in 2009, with no renewal options available. The Company entered into an agreement with NBT Bank to assume the deposits of the Hamlin location and the office was closed. The gain on the transaction was \$150,000 with expense related to the closing, including final lease payments, of \$46,000, included in other expense in the consolidated income statement.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheet of Norwood Financial Corp. and its subsidiary as of December 31, 2009, and the related consolidated statements of income, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of Norwood Financial Corp. and its subsidiary's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of Norwood Financial Corp. and its subsidiary for the years ended December 31, 2008 and 2007, were audited by other auditors whose report, dated March 10, 2009, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Norwood Financial Corp. and its subsidiary as of December 31, 2009, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

2100 Corporate Drive  
Suite 400  
Wexford, PA  
March 9, 2010

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheet of Norwood Financial Corp. and its subsidiary as of December 31, 2008, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the two-year period ended December 31, 2008. Norwood Financial Corp. and its subsidiary's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Norwood Financial Corp. and its subsidiary as of December 31, 2008, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

Parente Beard LLC  
Lancaster, Pennsylvania  
March 10, 2009

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## NORWOOD FINANCIAL CORP.

## CONSOLIDATED BALANCE SHEETS

	December 31, 2009	December 31, 2008
	(In Thousands, Except Share Data)	
<b>ASSETS</b>		
Cash and due from banks	\$6,498	\$6,463
Interest bearing deposits with banks	7,857	17
Federal funds sold	3,000	—
Cash and cash equivalents	17,355	6,480
Securities available for sale	130,577	130,120
Securities held to maturity, fair value 2009:\$722, 2008: \$720	708	707
Loans receivable (net of allowance for loan losses 2009 \$5,453; 2008 \$4,233)	358,021	345,171
Investment in Federal Home Loan Bank stock, at cost	3,538	3,538
Bank premises and equipment, net	5,189	5,490
Bank owned life insurance	7,889	8,068
Accrued interest receivables	2,200	2,179
Foreclosed real estate owned	392	660
Other assets	3,827	1,883
Total Assets	\$529,696	\$504,296
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Non-interest bearing demand	\$59,820	\$56,839
Interest bearing demand	34,410	35,322
Money market deposit accounts	60,035	60,623
Savings	44,423	44,577
Time	192,785	162,274
Total Deposits	391,473	359,635
Short-term borrowings	25,803	38,126
Other borrowings	43,000	43,000
Accrued interest payable	2,057	2,247
Other liabilities	2,892	2,598
Total Liabilities	465,225	445,606
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$.10 par value, authorized 10,000,000 shares, issued: 2,840,287	284	284
Surplus	9,764	9,972

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Retained earnings	54,455	50,398
Treasury stock, at cost: 2009: 68,436 shares, 2008: 104,310 shares	(2,122 )	(3,243 )
Accumulated other comprehensive income	2,090	1,279
Total Stockholders' Equity	64,471	58,690
Total Liabilities and Stockholders' Equity	\$529,696	\$504,296

See notes to consolidated financial statements

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## NORWOOD FINANCIAL CORP.

## CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2009	2008	2007
	(In Thousands, Except per Share Data)		
<b>INTEREST INCOME</b>			
Loans receivable, including fees	\$21,523	\$21,983	\$23,720
Securities			
Taxable	4,131	5,207	4,571
Tax exempt	1,162	876	743
Other	19	29	221
Total interest income	26,835	28,095	29,255
<b>INTEREST EXPENSE</b>			
Deposits	5,765	7,773	9,967
Short-term borrowings	292	693	932
Other borrowings	1,669	1,228	1,084
Total Interest Expense	7,726	9,694	11,983
Net Interest Income	19,109	18,401	17,272
<b>PROVISION FOR LOAN LOSSES</b>	1,685	735	315
Net Interest Income After Provision for Loan Losses	17,424	17,666	16,957
<b>OTHER INCOME</b>			
Service charges and fees	2,476	2,600	2,509
Income from fiduciary activities	354	404	423
Net realized gains (losses) on sales of securities	463	(18)	17
Gain on sale of loans and servicing rights	481	499	23
Earnings on life insurance policies	1,196	344	333
Gain on sale of deposits	150	—	—
Other	272	258	219
Total Other Income	5,392	4,087	3,524
<b>OTHER EXPENSES</b>			
Salaries and employee benefits	6,829	6,046	5,825
Occupancy	1,133	1,118	1,087
Furniture and equipment	458	507	553
Data processing related operations	788	753	690
Federal Deposit Insurance Corporation insurance assessment	710	90	43
Advertising	186	213	235
Professional fees	411	331	349
Postage and telephone	487	521	491
Taxes, other than income	484	504	414

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Foreclosed real estate owned	436	582	—
Amortization of intangible assets	52	52	52
Other	1,497	1,523	1,602
Total Other Expenses	13,471	12,240	11,341
Income before Income Taxes	9,345	9,513	9,140
INCOME TAX EXPENSE	2,282	2,836	2,629
Net income	\$7,063	\$6,677	\$6,511
EARNINGS PER SHARE			
BASIC	\$2.57	\$2.44	\$2.34
DILUTED	\$2.55	\$2.41	\$2.30

See notes to consolidated financial statements

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NORWOOD FINANCIAL CORP.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2009, 2008 and 2007

	Common Stock		Surplus	Retained Earnings	Treasury Stock		Accumulated	Total
	Shares	Amount			Comprehensive	Income	(Loss)	
	(Dollars in Thousands, Except per Share Data)							
BALANCE-DECEMBER 31, 2006	2,840,872	\$ 284	\$ 10,149	\$ 43,125	43,721	\$ (1,283 )	\$ (44 )	\$ 52,231
Comprehensive Income:								
Net Income	-	-	-	6,511	-	-	-	6,511
Change in unrealized gains on securities available for sale, net of reclassification adjustment and tax effects	-	-	-	-	-	-	1,098	1,098
Total Comprehensive income	-	-	-	-	-	-	-	7,609
Cash dividends declared \$0.94 per share	-	-	-	(2,606 )	-	-	-	(2,606 )
Acquisition of treasury stock	-	-	-	-	72,875	(2,313 )	-	(2,313 )
Stock options exercised	-	-	(404 )	-	(24,720)	745	-	341
Tax benefit on stock options exercised	-	-	162	-	-	-	-	162
Sale of treasury stock for ESOP	-	-	1	-	(4,620 )	143	-	144
Compensation expense related to stock options	-	-	251	-	-	-	-	251
BALANCE - DECEMBER 31, 2007	2,840,872	284	10,159	47,030	87,256	(2,708 )	1,054	55,819
Comprehensive Income:								
Net Income	-	-	-	6,677	-	-	-	6,677
Change in unrealized gains on securities available for sale,								