CITIZENS & NORTHERN CORP
Form 10-Q
August 08, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

OR

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

For the transition period from __________ to __________.

Commission file number: 000-16084

CITIZENS & NORTHERN CORPORATION

(Exact name of Registrant as specified in its charter)

PENNSYLVANIA	23-2451943
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

90-92 MAIN STREET, WELLSBORO, PA 16901

(Address of principal executive offices) (Zip code)

570-724-3411

(Registrant s telephone number including area code)

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

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

Common Stock ($1.00 par value)

8,896,174 Shares Outstanding on August 6, 2007

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Consolidated Balance Sheet
(In Thousands Except Share Data)

	June 30, 2007 (Unaudited)	December 31, 2006 (Note)
ASSETS		
Cash and due from banks:		
Non-interest-bearing	$ 20,959	$ 18,676
Interest-bearing	21,855	8,483
Total cash and cash equivalents	42,814	27,159
Trading securities	2,514	
Available-for-sale securities	344,283	356,665
Held-to-maturity securities	412	414
Loans, net	747,114	679,300
Bank-owned life insurance	21,140	16,388
Accrued interest receivable	5,028	5,046
Bank premises and equipment, net	28,531	23,129
Foreclosed assets held for sale	215	264
Intangible asset Core deposit intangibles	1,691	336
Intangible asset Goodwill	12,067	2,809
Other assets	19,174	15,858
TOTAL ASSETS	$1,224,983	$1,127,368
LIABILITIES		
Deposits:		
Non-interest-bearing	$ 120,832	$ 105,675
Interest-bearing	750,309	654,674
Total deposits	871,141	760,349
Dividends payable	2,138	1,969
Short-term borrowings	35,004	49,258
Long-term borrowings	167,704	179,182
Accrued interest and other liabilities	7,503	6,722
TOTAL LIABILITIES	1,083,490	997,480
STOCKHOLDERS EQUITY		
Common stock, par value $1.00 per share; authorized 20,000,000 shares in 2007 and 2006; issued 9,193,192 in 2007 and 8,472,382 in 2006	9,193	8,472

Stock dividend distributable		1,806
Paid-in capital	42,501	27,077
Retained earnings	96,344	96,077
Total	148,038	133,432
Accumulated other comprehensive (loss) income	(1,804)	613
Unamortized stock compensation	(106)	(11)
Treasury stock, at cost:		
284,518 shares at June 30, 2007	(4,635)	
262,598 shares at December 31, 2006		(4,146)
TOTAL STOCKHOLDERS EQUITY	141,493	129,888
TOTAL LIABILITIES & STOCKHOLDERS EQUITY	$1,224,983	$1,127,368

The accompanying notes are an integral part of these consolidated financial statements.

Note: The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date but does not include all the information and notes required by U.S. generally accepted accounting principles for complete financial statements.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
CONSOLIDATED STATEMENT OF INCOME
(In Thousands, Except Per Share Data) (Unaudited)

	3 Months Ended June 30, 2007 (Current)	3 Months Ended June 30, 2006 (Prior Year)	6 Months Ended June 30, 2007 (Current)	6 Months Ended June 30, 2006 (Prior Year)
INTEREST INCOME				
Interest and fees on loans	$ 12,679	$ 10,695	$ 23,960	$ 20,861
Interest on loans to political subdivisions	359	335	703	646
Interest on balances with depository institutions	32	23	58	35
Interest on federal funds sold	49	53	150	96
Interest on trading securities	16		19	
Income from available-for-sale and held-to-maturity securities:				
Taxable	3,643	3,550	7,140	7,277
Tax-exempt	700	1,046	1,427	2,382
Dividends	214	282	478	550
Total interest and dividend income	17,692	15,984	33,935	31,847
INTEREST EXPENSE				
Interest on deposits	6,453	5,298	12,343	10,307
Interest on short-term borrowings	490	623	965	1,049
Interest on long-term borrowings	1,736	1,645	3,371	3,488
Total interest expense	8,679	7,566	16,679	14,844
Interest margin	9,013	8,418	17,256	17,003
(Credit) provision for loan losses		(300)	229	300
Interest margin after (credit) provision for loan losses	9,013	8,718	17,027	16,703
OTHER INCOME				
Trust and financial management revenue	939	547	1,621	1,058
Service charges on deposit accounts	633	513	1,115	963
Service charges and fees	182	109	324	174
Insurance commissions, fees and premiums	144	121	260	260
Increase in cash surrender value of life insurance	174	153	319	300
Other operating income	572	494	1,093	971
Total other income before net (losses) gains on available-for-sale	2,644	1,937	4,732	3,726

securities				
Net (losses) gains on available-for-sale securities	(1,172)	1,333	(11)	2,648
Total other income	1,472	3,270	4,721	6,374
OTHER EXPENSES				
Salaries and wages	3,433	3,364	7,028	6,686
Pensions and other employee benefits	973	1,005	2,158	2,148
Occupancy expense, net	660	594	1,286	1,140
Furniture and equipment expense	751	668	1,396	1,318
Pennsylvania shares tax	235	244	471	488
Other operating expense	2,137	2,101	4,097	4,039
Total other expenses	8,189	7,976	16,436	15,819
Income before income tax provision	2,296	4,012	5,312	7,258
Income tax provision	360	813	918	1,239
NET INCOME	$ 1,936	$ 3,199	$ 4,394	$ 6,019
PER SHARE DATA:				
Net income basic	$ 0.22	$ 0.38	$ 0.52	$ 0.72
Net income diluted	$ 0.22	$ 0.38	$ 0.52	$ 0.72
Dividend per share	$ 0.24	$ 0.24	$ 0.48	$ 0.48
Number of shares used in computation basic	8,698,703	8,363,821	8,497,076	8,371,810
Number of shares used in computation diluted	8,711,732	8,386,723	8,512,559	8,402,130

The accompanying notes are an integral part of these consolidated financial statements.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
Consolidated Statement of Cash Flows
(In Thousands)

	6 Months Ended	
	June 30, 2007	June 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 4,394	$ 6,019
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	229	300
Realized losses (gains) on available for sale securities, net	11	(2,648)
Gain on sale of foreclosed assets, net	(76)	(52)
Gain on sale of premises and equipment		(26)
Depreciation expense	1,365	1,266
Loss from writedown of impaired premises and equipment		169
Accretion and amortization of securities, net	199	245
Other accretion and amortization, net	(63)	
Increase in cash surrender value of life insurance	(319)	(300)
Stock-based compensation	206	20
Amortization of core deposit intangibles	132	64
Net increase in trading securities	(2,514)	
Increase in accrued interest receivable and other assets	(1,708)	(2,902)
Increase in accrued interest payable and other liabilities	118	656
Net Cash Provided by Operating Activities	1,974	2,811
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from acquisition of Citizens Bancorp, Inc., net	29,952	
Proceeds from maturity of held-to-maturity securities	2	3
Proceeds from sales of available-for-sale securities	39,748	68,962
Proceeds from calls and maturities of available-for-sale securities	18,831	17,469
Purchase of available-for-sale securities	(23,672)	(26,556)
Purchase of Federal Home Loan Bank of Pittsburgh stock	(1,846)	(958)
Redemption of Federal Home Loan Bank of Pittsburgh stock	2,787	2,352
Net increase in loans	(8,046)	(6,215)
Return of principal on limited partnership investment	238	
Purchase of premises and equipment	(1,524)	(2,332)
Proceeds from sale of premises and equipment		222
Proceeds from sale of foreclosed assets	421	151
Net Cash Provided by Investing Activities	56,891	53,098
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	11,148	(591)
Net (decrease) increase in short-term borrowings	(15,680)	16,216
Proceeds from long-term borrowings	15,000	
Repayments of long-term borrowings	(49,195)	(51,316)

Purchase of treasury stock	(593)	(651)
Sale of treasury stock	88	49
Tax benefit from compensation plans		7
Dividends paid	(3,978)	(3,985)
Net Cash Used in Financing Activities	(43,210)	(40,271)
INCREASE IN CASH AND CASH EQUIVALENTS	15,655	15,638
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	27,159	26,446
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 42,814	$ 42,084

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
Consolidated Statement of Cash Flows
(In Thousands) (Unaudited) (Continued)

	6 Months Ended June 30, 2007	6 Months Ended June 30, 2006
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Assets acquired through foreclosure of real estate loans	$ 189	$ 559
Interest paid	$ 16,695	$14,958
Income taxes paid	$ 1,112	$ 1,500
ACQUISITION OF CITIZENS BANCORP, INC.:		
Cash and cash equivalents received	$ 44,264	$
Cash paid for acquisition	(14,312)	
Net cash received on acquisition	$ 29,952	$
NONCASH ASSETS RECEIVED, LIABILITIES ASSUMED AND EQUITY ISSUED FROM ACQUISITION OF CITIZENS BANCORP, INC.:		
Assets received:		
Available for sale securities	$ 26,426	$
Loans	60,151	
Bank-owned life insurance	4,433	
Premises and equipment	5,243	
Foreclosed assets	107	
Intangible asset core deposit intangible	1,487	
Intangible asset goodwill	9,258	
Other assets	1,567	
Total noncash assets received	$108,672	$
Liabilities assumed and equity issued:		
Deposits	$ 99,636	$
Short-term borrowings	1,426	
Long-term borrowings	22,753	
Other liabilities	735	
Equity issued, net	14,074	
Total noncash liabilities assumed and equity issued	$138,624	$

The accompanying notes are an integral part of these consolidated financial statements.

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Notes to Consolidated Financial Statements

1. BASIS OF INTERIM PRESENTATION

The consolidated financial statements include the accounts of Citizens & Northern Corporation and its subsidiaries, Citizens & Northern Bank (C&N Bank), Canisteo Valley Corporation, Bucktail Life Insurance Company and Citizens & Northern Investment Corporation (collectively, the Corporation). The consolidated financial statements also include the accounts of Canisteo Valley Corporation s wholly-owned subsidiary, First State Bank, and C&N Bank s wholly-owned subsidiary, C&N Financial Services Corporation. All material intercompany balances and transactions have been eliminated in consolidation.

The financial information included herein, with the exception of the consolidated balance sheet dated December 31, 2006, is unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods.

Results reported for the three-month and six-month periods ended June 30, 2007 might not be indicative of the results for the year ending December 31, 2007.

This document has not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation or any other regulatory agency.

2. PER SHARE DATA

Net income per share is based on the weighted-average number of shares of common stock outstanding. The number of shares used in calculating net income and cash dividends per share reflect the retroactive effect of stock dividends for all periods presented. The following data show the amounts used in computing net income per share and the weighted average number of shares of dilutive stock options. As shown in the table that follows, diluted earnings per share is computed using weighted average common shares outstanding, plus weighted-average common shares available from the exercise of all dilutive stock options, less the number of shares that could be repurchased with the proceeds of stock option exercises based on the average share price of the Corporation s common stock during the period.

	Net Income	Weighted-Average Common Shares	Earnings Per Share
Six Months Ended June 30, 2007			
Earnings per share basic	$4,394,000	8,497,076	$0.52
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		110,492	
Hypothetical share repurchase at $21.29		(95,009)	
Earnings per share diluted	$4,394,000	8,512,559	$0.52
Six Months Ended June 30, 2006			
Earnings per share basic	$6,019,000	8,371,810	$0.72
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		140,995	
Hypothetical share repurchase at $24.44		(110,675)	
Earnings per share diluted	$6,019,000	8,402,130	$0.72

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	Net Income	Weighted-Average Common Shares	Earnings Per Share
Quarter Ended June 30, 2007			
Earnings per share basic	$1,936,000	8,698,703	$0.22
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		109,616	
Hypothetical share repurchase at $20.73		(96,587)	
Earnings per share diluted	$1,936,000	8,711,732	$0.22
Quarter Ended June 30, 2006			
Earnings per share basic	$3,199,000	8,363,821	$0.38
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		122,005	
Hypothetical share repurchase at $22.70		(99,103)	
Earnings per share diluted	$3,199,000	8,386,723	$0.38

3. COMPREHENSIVE INCOME

U.S. generally accepted accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although unrealized gains and losses on available-for-sale securities are reported as a separate component of the equity section of the balance sheet, changes in unrealized gains and losses on available-for-sale securities, along with net income, are components of comprehensive income. Also, effective December 31, 2006, the Corporation applied Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS No. 158 requires the Corporation to recognize the underfunded or overfunded status of defined benefit postretirement plans as a liability or asset in the balance sheet. Beginning in 2007, changes in accumulated other comprehensive income attributable to the impact of SFAS No. 158 on defined benefit plans are included in other comprehensive income.

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

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	3 Months Ended		6 Months Ended	
(In Thousands)	**June 30, 2007**	**June 30, 2006**	**June 30, 2007**	**June 30, 2006**
Net income	$ 1,936	$ 3,199	$ 4,394	$ 6,019
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding losses on available-for-sale securities	(4,317)	(2,342)	(3,693)	(4,607)
Less: Reclassification adjustment for losses (gains) realized in income	1,172	(1,333)	11	(2,648)
Other comprehensive loss before income tax	(3,145)	(3,675)	(3,682)	(7,255)
Income tax related to unrealized loss on securities	1,069	1,254	1,252	2,468
Other comprehensive loss on securities	(2,076)	(2,421)	(2,430)	(4,787)
Unfunded pension and postretirement obligations:				
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	11		22	
Income tax related to other comprehensive gain	(4)		(9)	
Other comprehensive gain on unfunded retirement obligations	7		13	
Total comprehensive (loss) income	$ (133)	$ 778	$ 1,977	$ 1,232

4. SECURITIES

The Corporation s trading assets at June 30, 2007 were municipal bonds with an estimated fair value of $2,514,000. The consolidated income statement includes net losses from trading assets in the six months ended June 30, 2007 of $71,000, including a realized gain on the sale of a trading security of $6,000 in the first quarter and an unrealized holding loss of $77,000 in the second quarter. There was no trading activity in 2006.

Amortized cost and fair value of available-for-sale and held-to-maturity securities at June 30, 2007 are summarized as follows:

(In Thousands)	**Amortized Cost**	**Gross Unrealized Holding Gains**	**Gross Unrealized Holding Losses**	**Fair Value**
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of other U.S. Government agencies	$ 30,884	$ 2	$ (468)	$ 30,418
Obligations of states and political subdivisions	61,519	276	(1,500)	60,295
Mortgage-backed securities	110,060	91	(1,681)	108,470
Collateralized mortgage obligations	36,554		(1,196)	35,358
Other securities	84,193	856	(772)	84,277

Total debt securities	323,210	1,225	(5,617)	318,818
Marketable equity securities	22,042	4,218	(795)	25,465
Total	$345,252	$5,443	$(6,412)	$344,283
HELD-TO-MATURITY SECURITIES:				
Obligations of the U.S. Treasury	$ 309	$ 3	$	$ 312
Obligations of other U.S. Government agencies	99	4		103
Mortgage-backed securities	4			4
Total	$ 412	$ 7	$	$ 419

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The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2007.

	Less Than 12 Months		12 Months or More		Total	
June 30, 2007 (In Thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
AVAILABLE-FOR-SALE SECURITIES:						
Obligations of other U.S. Government agencies	$ 3,676	$ (24)	$ 24,556	$ (444)	$ 28,232	$ (468)
Obligations of states and political subdivisions	26,293	(1,136)	12,586	(364)	38,879	(1,500)
Mortgage-backed securities	20,703	(315)	39,279	(1,366)	59,982	(1,681)
Collateralized mortgage obligations	5,464	(41)	29,894	(1,155)	35,358	(1,196)
Other securities	25,239	(240)	29,017	(532)	54,256	(772)
Total debt securities	81,375	(1,756)	135,332	(3,861)	216,707	(5,617)
Marketable equity securities	6,898	(515)	2,047	(280)	8,945	(795)
Total temporarily impaired available-for-sale securities	$88,273	$(2,271)	$137,379	$(4,141)	$225,652	$(6,412)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

In the second quarter 2007, management determined that adjustable rate mortgage-backed securities with a face value totaling $44,509,000 were other-than-temporarily impaired. The Corporation sold the securities in July 2007, and recorded a loss of $1,780,000 (pre-tax) in the second quarter 2007. As a result of changes in market conditions, the loss from sale in July exceeded the amount of loss recorded in the first six months of 2007 by $265,000. The additional loss will be recorded in the third quarter 2007. Management made the decision to sell the securities based on an analysis of substantially all of the debt securities with unrealized losses. For the securities which management decided to sell, the average yield in the second quarter 2007 was 4.41%. Proceeds from the sales were used to purchase a combination of mortgage-backed securities and other securities for a yield of approximately 6%. At current interest rates, management expects the total increase in earnings from the new securities to equal the amount of up-front loss on the sale in approximately three years, while the average remaining life of the sold securities is estimated to be at least four years. For the remaining debt securities in an unrealized loss position, management determined that it was unlikely the increase in earnings from reinvestment at higher rates would exceed the amount of loss from sale over a time frame less than the average lives of the securities; accordingly, management intends to hold substantially all of the remaining securities until market recovery or maturity.

The unrealized losses on other debt securities are primarily the result of volatility in interest rates. Based on the credit worthiness of the issuers, which are almost exclusively U.S. Government agencies or state and political subdivisions, and the economic analysis referred to above, management believes the Corporation s other debt securities at June 30, 2007 were not other-than-temporarily impaired.

5. DEFINED BENEFIT PLANS

The Corporation has a noncontributory defined benefit pension plan for all employees meeting certain age and length of service requirements. Benefits are based primarily on years of service and the average annual compensation during the highest five consecutive years.

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In addition, the Corporation sponsors a defined benefit health care plan that provides postretirement medical benefits and life insurance to employees who meet certain age and length of service requirements. This plan contains a cost-sharing feature, which causes participants to pay for all future increases in costs related to benefit coverage. Accordingly, actuarial assumptions related to health care cost trend rates do not affect the liability balance at June 30, 2007 and December 31, 2006, and will not affect the Corporation s future expenses.

The Corporation uses a December 31 measurement date for its plans.

The components of net periodic benefit costs from these defined benefit plans are as follows:

	Pension Six Months Ended June 30,		**Postretirement Six Months Ended June 30,**	
(In Thousands)	**2007**	**2006**	**2007**	**2006**
Service cost	$ 342	$ 305	$37	$32
Interest cost	350	315	35	31
Expected return on plan assets	(459)	(416)		
Amortization of transition (asset) obligation	(12)	(12)	18	18
Amortization of prior service cost	4	4		
Recognized net actuarial loss	23	35	1	1
Net periodic benefit cost	$ 248	$ 231	$91	$82

	Pension Three Months Ended June 30,		**Postretirement Three Months Ended June 30,**	
(In Thousands)	**2007**	**2006**	**2007**	**2006**
Service cost	$ 171	$ 153	$19	$16
Interest cost	175	158	18	16
Expected return on plan assets	(229)	(208)		
Amortization of transition (asset) obligation	(6)	(6)	9	9
Amortization of prior service cost	2	2		
Recognized net actuarial loss	12	17		
Net periodic benefit cost (benefit)	$ 125	$ 116	$46	$41

For the defined benefit pension plan, the Corporation has a minimum required employer contribution of $156,000 for the year ended December 31, 2007. The Corporation has not yet made its defined benefit pension plan contribution for 2007. Through the second quarter of 2007, the Corporation has funded postretirement contributions totaling $29,000, with estimated annual postretirement contributions, net of anticipated reimbursements from the Medicare (Part D) program, of $33,000 expected in 2007 for the full year.

6. STOCK-BASED COMPENSATION PLANS

In January 2007, the Corporation granted options to purchase a total of 43,385 shares of common stock through its Stock Incentive and Independent Directors Stock Incentive Plans. The exercise price for these options is $22.325 per share, which was the market price as of the date of grant. The Corporation neither modified, nor issued, any new options in 2006.

SFAS No. 123R requires the Corporation to record stock option expense based on estimated fair value calculated using an option valuation model. The fair value of each option granted in 2007 was estimated to be $4.46 per share as of the grant date. In calculating the fair value, the Corporation utilized the Black-Scholes option-pricing model with the following assumptions:

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Volatility	23%
Expected option lives	8 years
Risk-free interest rate	4.69%
Dividend yield	3.61%

In calculating the estimated fair value of the 2007 stock option awards, the Corporation utilized its historical volatility and dividend yield over the immediately prior 8-year period to estimate future levels of volatility and dividend yield. The risk-free interest rate was based on the published yield of zero-coupon U.S. Treasury strips with an 8-year maturity as of the grant dates. The 8-year term was based on management s estimate of the average term for all options issued under both plans.

In calculating stock option expense for the 2007 stock option awards, management assumed a 23% forfeiture rate for options granted under the Stock Incentive Plan, and a 0% forfeiture rate for the Directors Stock Incentive Plan. These estimated forfeiture rates were determined based on the Corporation s historical experience.

Also, effective in January 2007, the Corporation awarded a total of 5,835 shares of restricted stock under the Stock Incentive and Independent Directors Stock Incentive Plans. Compensation cost related to restricted stock is recognized based on the market price of the stock at the grant date over the vesting period.

Total stock-based compensation expense is as follows:

	3 Months Ended		Fiscal Year To Date 6 Months Ended June 30,	
(In Thousands)	**June 30, 2007 (Current)**	**June 30, 2006 (Prior Year)**	**2007 (Current)**	**2006 (Prior Year)**
Stock options	$ 77	$	$ 156	$
Restricted stock	26	10	50	20
Total	$ 103	$ 10	$ 206	$ 20

Stock option expense has been recognized over the six-month vesting period for the 2007 awards. Management expects there will be no stock option expense in the last six months of 2007.

7. CONTINGENCIES

In the normal course of business, the Corporation may be subject to pending and threatened lawsuits in which claims for monetary damages could be asserted. In management s opinion, the Corporation s financial position and results of operations would not be materially affected by the outcome of such pending legal proceedings.

8. MERGER

On May 1, 2007, the Corporation completed its acquisition of 100% of the outstanding voting stock of Citizens Bancorp, Inc. (Citizens.) Accordingly, the results of operations for the former Citizens have been included in the accompanying consolidated financial statements from that date forward. In connection with the transaction, Citizens Trust Company, the banking subsidiary of Citizens, has merged with and into Citizens & Northern Bank (C&N Bank), a subsidiary of the Corporation. The Corporation s management believes the acquisition of Citizens provides two significant benefits: (1) extension of its geographic market for banking services, which should provide growth opportunities, and (2) addition of management personnel with background and skills complementary to the Corporation s management personnel.

The aggregate acquisition price was $28,386,000, which included cash of $14,312,000 and 636,967 shares of the Corporation s common stock valued at $14,074,000. The value of the stock issued was determined based on the average market price of the shares over the seven days before and after the date the terms of the acquisition agreement were negotiated and publicly announced, adjusted for the values of Citizens shares held prior to the merger announcement and Corporation shares that were held by Citizens.

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The Corporation is in the process of obtaining final valuations on loans, intangible assets, premises and equipment, deposits and other liabilities; accordingly, allocation of the purchase price is subject to modification in the future. Information regarding the purchase price and estimated fair values of assets acquired and liabilities assumed as of the acquisition date is provided as supplemental information in the consolidated statement of cash flows. Following are pro forma income statement amounts, without adjustment for the material nonrecurring items described below, assuming the acquisition was made on January 1, 2006:

	3 Months Ended		Fiscal Year To Date 6 Months Ended June 30,	
(In Thousands)	June 30, 2007 (Current)	June 30, 2006 (Prior Year)	2007 (Current)	2006 (Prior Year)
Net interest income	$18,033	$16,977	$35,296	$33,787
Net income	$ 1,186	$ 3,520	$ 3,942	$ 6,606
Net income per share basic	$ 0.13	$ 0.39	$ 0.44	$ 0.73
Net income per share diluted	$ 0.13	$ 0.39	$ 0.44	$ 0.73

Citizens recorded material, nonrecurring expenses and losses which reduced pro forma net income (included in the table immediately above) by $787,000 for the three months ended June 30, 2007 and $764,000 for the six months ended June 30, 2007. These nonrecurring items included merger-related professional expense, acceleration of Pennsylvania Bank Shares Tax expense (recognition of the remaining 9 months expense in the month of April 2007) and realized losses from sales of securities. Excluding the effect of these nonrecurring items, pro forma income statement amounts (assuming the acquisition was made on January 1, 2006) are as follows:

	3 Months Ended		Fiscal Year To Date 6 Months Ended June 30,	
(In Thousands)	June 30, 2007 (Current)	June 30, 2006 (Prior Year)	2007 (Current)	2006 (Prior Year)
Net income	$1,973	$3,520	$4,706	$6,606
Net income per share basic	$ 0.22	$ 0.39	$ 0.53	$ 0.73
Net income per share diluted	$ 0.22	$ 0.39	$ 0.53	$ 0.73

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CITIZENS & NORTHERN CORPORATION FORM 10-Q

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements in this section and elsewhere in this quarterly report on Form 10-Q are forward-looking statements. Citizens & Northern Corporation and its wholly-owned subsidiaries intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995. Forward-looking statements, which are not historical facts, are based on certain assumptions and describe future plans, business objectives and expectations, and are generally identifiable by the use of words such as, should , likely , expect , plan , anticipate , target , forecast , and goal . These forward-looking statements are subject to risks and uncertainties that are difficult to predict, may be beyond management s control and could cause results to differ materially from those expressed or implied by such forward-looking statements. Factors which could have a material, adverse impact on the operations and future prospects of the Corporation include, but are not limited to, the following:

- changes in monetary and fiscal policies of the Federal Reserve Board and the U. S. Government, particularly related to changes in interest rates
- changes in general economic conditions
- legislative or regulatory changes
- downturn in demand for loan, deposit and other financial services in the Corporation s market area
- increased competition from other banks and non-bank providers of financial services
- technological changes and increased technology-related costs
- changes in accounting principles, or the application of generally accepted accounting principles.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

REFERENCES TO 2007 AND 2006

Unless otherwise noted, all references to 2007 in the following discussion of operating results are intended to mean the six months ended June 30, 2007, and similarly, references to 2006 relate to the six months ended June 30, 2006.

EARNINGS OVERVIEW

Net income totaled $4,394,000 in the first six months of 2007, down 27% from the first six months of 2006. Net income per share was $0.52 (basic and diluted) in the first six months of 2007, down 28% from the first six months of 2006. Return on average assets was 0.76% in the first six months of 2007, as compared to 1.05% in the first six months of 2006. Return on average equity was 6.53% in the six months ended June 30, 2007, as compared to 9.17% in the six months ended June 30, 2006.

Earnings results for the first six months of 2007 were impacted by a loss (net of tax) on impaired securities of $1,175,000. The loss from impaired securities reduced net income per share by $0.14 (basic) and $0.13 (diluted) for the first six months of 2007. The securities classified as impaired were adjustable rate mortgage-backed securities with a face value totaling $44,509,000, and were sold in July 2007. As a result of changes in market conditions, the loss from sale in July exceeded the amount of loss recorded in the first six months of 2007 by $177,000, net of tax. The additional loss will be recorded in the third quarter 2007. For the securities which management decided to sell, the average yield in the second quarter 2007 was 4.41%. Proceeds from the sales were used to purchase a combination of mortgage-backed securities and other securities for a yield of approximately 6%. At current interest rates, management expects the total increase in earnings from the new securities to equal the amount of up-front loss on the sale in approximately three years, while the average remaining life of the sold securities is estimated to be at least four years.

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On May 1, 2007, the acquisition of Citizens Bancorp, Inc. became effective. Citizens Bancorp, Inc. was the parent company of Citizens Trust Company, with offices in Coudersport, Port Allegany and Emporium, PA. The Citizens Trust Company operations, which are now part of Citizens & Northern Bank, contributed significantly to growth in total assets, including loans, as well to growth in deposits and trust assets under management and increases in revenues and expenses in the second quarter 2007.

Significant income statement changes between 2007 and 2006 were as follows:

The Corporation had net (pre-tax) realized losses from sales of available-for-sale securities of $11,000 in 2007, as compared to net realized gains of $2,648,000 in 2006. Excluding the $1,780,000 (pre-tax) loss on impaired securities described above, net securities gains for the six months ended June 30, 2007 totaled $1,769,000, down $879,000 from the first six months of 2006. Most of the gains realized in both periods were from sales of bank stocks.

The net interest margin increased $253,000, or 1.5%, in 2007 as compared to 2006. As discussed in the Net Interest Margin section of Management s Discussion and Analysis, on a fully taxable equivalent basis, the net interest margin fell $158,000 in 2007 as compared to 2006. The acquisition of Citizens Trust Company resulted in increased interest and fees on loans, and provided funding the Corporation used to pay off borrowings. Overall, the Corporation has been hampered by the flat or inverted yield curve throughout 2006 and 2007, which has limited opportunities to earn a positive spread from maintaining borrowed funds and holding investment securities. Accordingly, the Corporation has sold securities and repaid borrowings throughout much of 2007 and 2006.

Noninterest revenue increased $1,006,000, or 27.0%, in 2007 over 2006. Trust and Financial Management revenue increased $563,000 (53.2%), including an increase of 40.0% excluding Citizens Trust Company, and a contribution to revenue from Citizens Trust Company of $140,000. Other significant increases in noninterest revenue included: service charges on deposits, which increased $152,000 (including $101,000 from Citizens Trust Company), and increases in fees for letter of credit, credit card (as a third party agent) and debit card services totaling $204,000.

Noninterest expense increased $617,000 (3.9%) in 2007 over 2006. Excluding the addition of Citizens Trust Company, total noninterest expense would have been approximately the same in 2007 as in 2006. Changes in components of noninterest expense are discussed later in Management s Discussion and Analysis.

The income tax provision decreased to $918,000 in 2007 from $1,239,000 in 2006, as a result of lower pre-tax earnings.

Second Quarter 2007

Second quarter 2007 results were impacted by the securities impairment loss described above. Net income in the second quarter 2007 was $1,936,000, down $1,263,000 (39.5%) from second quarter 2006 and down $522,000 (21.2%) from the first quarter 2007. Net income per share (basic and diluted) was $0.22 in the second quarter 2007, as compared to $0.38 (basic and diluted) in the second quarter 2006, and $0.30 per share (basic and diluted) in the first quarter 2007. Excluding the securities impairment loss, net income per share (basic and diluted) would have been $0.36 per share in the second quarter 2007.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE I QUARTERLY FINANCIAL DATA
(In Thousands)

	June 30, 2007	Mar. 31, 2007	Dec. 31, 2006	Sept. 30, 2006	June 30, 2006	Mar. 31, 2006
Interest income	$17,692	$16,243	$16,463	$16,152	$15,984	$15,863
Interest expense	8,679	8,000	8,097	7,833	7,566	7,278
Interest margin	9,013	8,243	8,366	8,319	8,418	8,585
Provision for loan losses		229	181	191	(300)	600
Interest margin after provision for loan losses	9,013	8,014	8,185	8,128	8,718	7,985
Other income	2,644	2,088	2,045	2,199	1,937	1,789
Net (losses) gains on available-for-sale securities	(1,172)	1,161	796	1,602	1,333	1,315
Gain from sale of credit card loans			340			
Other expenses	8,189	8,247	8,155	7,640	7,976	7,843
Income before income tax provision	2,296	3,016	3,211	4,289	4,012	3,246
Income tax provision	360	558	517	1,016	813	426
Net income	$ 1,936	$ 2,458	$ 2,694	$ 3,273	$ 3,199	$ 2,820
Net income per share basic	$ 0.22	$ 0.30	$ 0.32	$ 0.39	$ 0.38	$ 0.34
Net income per share diluted	$ 0.22	$ 0.30	$ 0.32	$ 0.39	$ 0.38	$ 0.33

The number of shares used in calculating net income per share for each quarter presented in Table I reflects the retroactive effect of stock dividends.

Prospects for the Remainder of 2007

The flat or inverted yield curve, which has been in existence for approximately 2 1/2 years, continues to challenge the Corporation s ability to achieve earnings growth, and it is apparent that changes are necessary to improve profitability. Management expects the securities portfolio restructuring referred to in the Earnings Overview section of Management s Discussion and Analysis to increase interest income approximately $290,000 over the remainder of 2007. Also, management has begun several initiatives designed to increase revenues and reduce expenses over the remainder of 2007 and 2008. Management expects some of the initiatives to immediately increase revenues or decrease expenses, while other changes may result in an up front cost or expense, followed by future improvements. Looking beyond the end of 2007, management expects that expansion of the Corporation s footprint including in 2005 through 2007 the construction or acquisition of banking facilities in Lycoming County, PA, New York State (First State Bank) and most recently, the Citizens Trust Company locations will produce opportunities to increase profitability by increasing loans, deposits and Trust and Financial Management volume. While management expects these activities to result in positive contributions to earnings in the future, the net impact for the year ending

December 31, 2007 cannot be determined.

Another major variable that affects the Corporation s earnings is securities gains and losses, particularly from bank stocks and other equity securities. Management s decisions regarding sales of securities are based on a variety of factors, with the overall goal of maximizing portfolio return over a long-term horizon. It is difficult to predict, with much precision, the amount of net securities gains and losses that will be realized throughout the remainder of 2007.

CRITICAL ACCOUNTING POLICIES

The presentation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

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A material estimate that is particularly susceptible to significant change is the determination of the allowance for loan losses. Management believes that the allowance for loan losses is adequate and reasonable. The Corporation s methodology for determining the allowance for loan losses is described in a separate section later in Management s Discussion and Analysis. Given the very subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions, and could, therefore, calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation s allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Corporation s debt securities. The Corporation receives estimated fair values of debt securities from an independent valuation service, or from brokers. In developing these fair values, the valuation service and the brokers use estimates of cash flows, based on historical performance of similar instruments in similar interest rate environments. Based on experience, management is aware that estimated fair values of debt securities tend to vary among brokers and other valuation services. Accordingly, when selling debt securities, management typically obtains price quotes from more than one source. The large majority of the Corporation s securities are classified as available-for-sale. Accordingly, these securities are carried at fair value on the consolidated balance sheet, with unrealized gains and losses excluded from earnings and reported separately through accumulated other comprehensive income (included in stockholders equity).

NET INTEREST MARGIN

The Corporation s primary source of operating income is represented by the net interest margin. The net interest margin is equal to the difference between the amounts of interest income and interest expense. Tables II, III and IV include information regarding the Corporation s net interest margin for 2007 and 2006. In each of these tables, the amounts of interest income earned on tax-exempt securities and loans have been adjusted to a fully taxable-equivalent basis. Accordingly, the net interest margin amounts reflected in these tables exceed the amounts presented in the consolidated financial statements. The discussion that follows is based on amounts in the related Tables.

The fully taxable equivalent net interest margin was $18,221,000 in 2007, $158,000 (0.9%) lower than in 2006. As shown in Table IV, net increases in volume had the effect of increasing net interest income $411,000 in 2007 over 2006 while interest rate changes had the effect of decreasing net interest income $569,000. Increases in volume of earning assets and interest-bearing liabilities were significantly affected by the acquisition of Citizens Trust Company on May 1, 2007. The most significant components of the volume changes in 2007 were an increase of $2,046,000 attributable to loan growth and a decrease in interest expense on short-term and long-term borrowings of $706,000, partially offset by lower interest income of $1,818,000 from available-for-sale securities and an increase in interest expense of $496,000 on certificates of deposit. As presented in Table III, the Interest Rate Spread (excess of average rate of return on interest-bearing assets over average cost of funds on interest-bearing liabilities) was 2.83% in the first six months of 2007, as compared to 2.90% for the year ended December 31, 2006 and 2.98% in the first six months of 2006.

INTEREST INCOME AND EARNING ASSETS

Interest income totaled $34,900,000 in 2007, an increase of 5.0% over 2006. Interest and fees from loans increased $3,179,000, or 14.6%, while income from available-for-sale securities decreased $1,607,000, or 14.2%. As indicated in Table III, total average available-for-sale securities in 2007 fell to $348,162,000, a decrease of $58,752,000 or 14.4% from 2006. Throughout the calendar year 2006 and the first half of 2007, proceeds from sales and maturities of securities were used, in part, to help fund loans and pay off borrowings. Within the available-for-sale securities portfolio, the average balance of municipal bonds shrunk by $43,573,000 in 2007 as compared to 2006. Management decided to reduce the Corporation s investment in municipal bonds in order to reduce the alternative minimum tax liability. The average rate of return on available-for-sale securities was 5.60% for 2007, in line with the 5.55% return for the year ended December 31, 2006 and 5.59% in the first half of 2006.

The average balance of gross loans increased 9.1% to $712,858,000 in 2007 from $653,577,000 in the first half of 2006. Excluding Citizens Trust Company, average loans increased 5.9%. The Corporation has experienced an increase in average balances of both residential mortgage and commercial loans in 2007. The average rate of return on loans was 7.07% in 2007, up from 6.81% for the year ended December 31, 2006 and 6.73% in the first half of 2006.

INTEREST EXPENSE AND INTEREST-BEARING LIABILITIES

Interest expense rose $1,835,000, or 12.4%, to $16,679,000 in 2007 from $14,844,000 in 2006. Table III shows that the overall cost of funds on interest-bearing liabilities rose to 3.74% in 2007, from 3.44% for the year ended December 31, 2006 and 3.30% in the first half of 2006.

From Table III, you can calculate that total average deposits (interest-bearing and noninterest-bearing) increased 5.4%, to $792,390,000 in 2007 from $752,127,000 in the first half of 2006. Excluding Citizens Trust Company, total average deposits increased only slightly (0.7%). The average rate incurred on certificates of deposit has increased significantly in 2007 over the first half of 2006, to 4.46% from 3.75%. Also, the average rate on Individual Retirement Accounts increased significantly, to 4.59% in 2007 from 3.98% in the first half of 2006.

The combined average total short-term and long-term borrowed funds decreased $38,926,000 to $216,299,000 in 2007 from $255,225,000 in the first half of 2006. With the yield curve being flat or inverted throughout 2006 and 2007, opportunities have been limited for earning a positive spread by purchasing or holding investment securities as compared to interest costs associated with maintaining borrowed funds. Accordingly, the Corporation has been paying off many borrowings as they mature. The average rate on long-term borrowings was 4.06% in 2007, up from 3.50% in the first half of 2006.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE II ANALYSIS OF INTEREST INCOME AND EXPENSE

	Six Months Ended June 30,		
(In Thousands)	**2007**	**2006**	**Increase/ (Decrease)**
INTEREST INCOME			
Available-for-sale securities:			
Taxable	$ 7,606	$ 7,815	$ (209)
Tax-exempt	2,069	3,467	(1,398)
Total available-for-sale securities	9,675	11,282	(1,607)
Held-to-maturity securities,			
Taxable	12	12	
Trading securities	28		28
Interest-bearing due from banks	58	35	23
Federal funds sold	150	96	54
Loans:			
Taxable	23,960	20,861	3,099
Tax-exempt	1,017	937	80
Total loans	24,977	21,798	3,179
Total Interest Income	34,900	33,223	1,677
INTEREST EXPENSE			
Interest checking	1,025	936	89
Money market	3,003	2,828	175
Savings	167	172	(5)
Certificates of deposit	5,245	3,952	1,293
Individual Retirement Accounts	2,900	2,416	484
Other time deposits	3	3	
Short-term borrowings	965	1,049	(84)
Long-term borrowings	3,371	3,488	(117)
Total Interest Expense	16,679	14,844	1,835
Net Interest Income	$18,221	$18,379	$ (158)

Note: Interest income from tax-exempt securities and loans has been adjusted to a fully tax-equivalent basis, using the Corporation s marginal federal income tax rate of 34%.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
Table III Analysis of Average Daily Balances and Rates

(Dollars in Thousands)	6 Months Ended 6/30/2007 Average Balance	Rate of Return/ Cost of Funds %	Year Ended 12/31/2006 Average Balance	Rate of Return/ Cost of Funds %	6 Months Ended 6/30/2006 Average Balance	Rate of Return/ Cost of Funds %
EARNING ASSETS						
Available-for-sale securities, at amortized cost:						
Taxable	$ 284,469	5.39%	$ 295,138	5.25%	$ 299,648	5.26%
Tax-exempt	63,693	6.55%	89,981	6.51%	107,266	6.52%
Total available-for-sale securities	348,162	5.60%	385,119	5.55%	406,914	5.59%
Held-to-maturity securities, Taxable	413	5.86%	418	5.74%	420	5.76%
Trading securities	943	5.99%		0.00%		0.00%
Interest-bearing due from banks	2,481	4.71%	2,272	4.01%	1,973	3.58%
Federal funds sold	6,223	4.86%	4,580	5.48%	3,388	5.71%
Loans:						
Taxable	680,346	7.10%	631,969	6.84%	622,647	6.76%
Tax-exempt	32,512	6.31%	30,745	6.19%	30,930	6.11%
Total loans	712,858	7.07%	662,714	6.81%	653,577	6.73%
Total Earning Assets	1,071,080	6.57%	1,055,103	6.34%	1,066,272	6.28%
Cash	18,777		19,027		19,351	
Unrealized gain/loss on securities	2,046		3,151		4,757	
Allowance for loan losses	(8,539)		(8,495)		(8,792)	
Bank premises and equipment	25,237		23,491		23,519	
Intangible Asset Core Deposit Intangible	1,036		389		410	
Intangible Asset Goodwill	5,645		2,912		2,919	
Other assets	38,771		39,111		38,036	
Total Assets	$1,154,053		$1,134,689		$1,146,472	
INTEREST-BEARING LIABILITIES						
Interest checking	$ 73,868	2.80%	$ 68,369	2.61%	$ 72,519	2.60%
Money market	182,909	3.31%	179,288	3.24%	179,277	3.18%

Savings	61,387	0.55%	62,030	0.54%	63,701	0.54%
Certificates of deposit	237,390	4.46%	215,460	3.96%	212,494	3.75%
Individual Retirement Accounts	127,286	4.59%	122,459	4.28%	122,544	3.98%
Other time deposits	1,172	0.52%	1,116	0.63%	1,065	0.57%
Short-term borrowings	48,724	3.97%	56,606	4.09%	54,004	3.92%
Long-term borrowings	167,575	4.06%	188,077	3.59%	201,221	3.50%
Total Interest-bearing Liabilities	900,311	3.74%	893,405	3.44%	906,825	3.30%
Demand deposits	108,378		102,260		100,527	
Other liabilities	10,053		7,942		7,915	
Total Liabilities	1,018,742		1,003,607		1,015,267	
Stockholders equity, excluding other comprehensive income/loss	135,126		129,004		128,088	
Other comprehensive income/loss	185		2,078		3,117	
Total Stockholders Equity	135,311		131,082		131,205	
Total Liabilities and Stockholders Equity	$1,154,053		$1,134,689		$1,146,472	
Interest Rate Spread		2.83%		2.90%		2.98%
Net Interest Income/Earning Assets		3.43%		3.42%		3.48%

(1) Rates of return on tax-exempt securities and loans are presented on a fully taxable-equivalent basis.

(2) Nonaccrual loans have been included with loans for the purpose of analyzing net interest earnings.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE IV ANALYSIS OF VOLUME AND RATE CHANGES
(In Thousands)

	YTD Ended 6/30/07 vs. 6/30/06		
	Change in Volume	**Change in Rate**	**Total Change**
EARNING ASSETS			
Available-for-sale securities:			
Taxable	$ (403)	$ 194	$ (209)
Tax-exempt	(1,415)	17	(1,398)
Total available-for-sale securities	(1,818)	211	(1,607)
Held-to-maturity securities, Taxable			
Trading securities	28		28
Interest-bearing due from banks	10	13	23
Federal funds sold	70	(16)	54
Loans:			
Taxable	1,997	1,102	3,099
Tax-exempt	49	31	80
Total loans	2,046	1,133	3,179
Total Interest Income	336	1,341	1,677
INTEREST-BEARING LIABILITIES			
Interest checking	17	72	89
Money market	58	117	175
Savings	(6)	1	(5)
Certificates of deposit	496	797	1,293
Individual Retirement Accounts	96	388	484
Other time deposits			
Short-term borrowings	(105)	21	(84)
Long-term borrowings	(631)	514	(117)
Total Interest Expense	(75)	1,910	1,835
Net Interest Income	$ 411	$ (569)	$ (158)

(1) Changes in income on tax-exempt securities and loans are presented on a fully

taxable-equivalent basis, using the Corporation s marginal federal income tax rate of 34%.

(2) The change in interest due to both volume and rates has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amount of the change in each.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE V COMPARISON OF NONINTEREST INCOME
(In Thousands)

	6 Months Ended June 30, 2007	June 30, 2006
Trust and financial management revenue	$1,621	$1,058
Service charges on deposit accounts	1,115	963
Service charges and fees	324	174
Insurance commissions, fees and premiums	260	260
Increase in cash surrender value of life insurance	319	300
Other operating income	1,093	971
Total other operating income, before realized (losses) gains on securities, net	4,732	3,726
Realized (losses) gains on available-for-sale securities, net	(11)	2,648
Total Other Income	$4,721	$6,374

Securities gains and losses are discussed in the Earnings Overview section of Management s Discussion and Analysis. Excluding securities gains and losses, total noninterest income increased $1,006,000 or 27.0%, in 2007 compared to 2006. Items of significance are as follows:

Trust and financial management revenue increased $563,000 (53.2%), including an increase of 40.0% excluding Citizens Trust Company, and a contribution to revenue from Citizens Trust Company of $140,000. Trust and financial management revenues are heavily affected by the amount of assets under management. Assets under management have increased 39.9% over the last 12 months, to $666,425,000 at June 30, 2007. The increase in assets under management includes the impact of the addition of Citizens Trust Company, as well as significant appreciation in equity markets. Excluding Citizens Trust Company, assets under management increased 18.4% as of June 30, 2007 compared to one year earlier.

Service charges on deposit accounts increased $152,000, or 15.8%, in 2007 as compared to 2006, including $101,000 from Citizens Trust Company.

Service charges and fees increased $150,000 in 2007 over 2006. Among the types of fees included in this category are letter of credit fees, which increased $79,000 in 2007 because of a few large, commercial transactions, and ATM-related fees, which increased $47,000 in 2007 over 2006.

Other operating income increased $122,000, or 12.6%, in 2007 over 2006. Included in this category was an increase of $67,000 in fees from credit card agent bank activities. In the first five months of 2006, the Corporation was in the final stages of processing transactions for the credit card portfolio that was sold in the fourth quarter 2005. Accordingly, costs associated with processing and exiting that activity, net of interchange and other fees, were charged against a liability that had been established in 2005 for the estimated remaining servicing cost. Since the Corporation no longer services credit card transactions, fees received in 2007 have been included in other operating income. Also included in this category were increases in interchange fees related to debit card transactions of $58,000 and broker-dealer revenues of $43,000, and net losses on trading securities of $72,000.

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CITIZENS & NORTHERN CORPORATION FORM 10-Q
TABLE VI- COMPARISON OF NONINTEREST EXPENSE
(In Thousands)

	6 Months Ended	
	June 30, 2007	June 30, 2006
Salaries and wages	$ 7,028	$ 6,686
Pensions and other employee benefits	2,158	2,148
Occupancy expense, net	1,286	1,140
Furniture and equipment expense	1,396	1,318
Pennsylvania shares tax	471	488
Other operating expense	4,097	4,039
Total Other Expense	$16,436	$15,819

Total noninterest expense increased $617,000, or 3.9%, in 2007 over 2006. Items of significance are as follows:

Salaries and wages increased $342,000, or 5.1%. Approximately $174,000 of the increase is attributable to the addition of Citizens Trust Company. Also included in this category is an increase in stock-based compensation totaling $164,000. As described in more detail in Note 6 to the consolidated financial statements, the Corporation made awards of stock options and restricted stock in 2007, but did not make any such awards in 2006. Stock option expense has been recognized over the six-month vesting period for the 2007 awards. In the last six months of 2007, management expects the total amount of stock-based compensation expense to be insignificant.

Total pensions and other employee benefits expense increased only $10,000, or 0.5%. In 2007, the Corporation received a refund from its health insurance provider based on favorable claims experience from a prior year, and health insurance expense is $172,000 lower in 2007 than 2006. Excluding health insurance, pensions and other employee benefits expense is 11.0% higher in 2007 than in 2006, including increases attributable to higher numbers of employees and other factors.

Occupancy expense increased $146,000, or 12.8%. In March 2006, the administration building in Wellsboro and the Old Lycoming Township branch were opened. The increase in occupancy expense associated with operating those properties for 6 months in 2007, as opposed to 4 months in 2006, was $95,000. Also, the acquisition of the Citizens Trust Company locations resulted in occupancy costs in 2007 of $63,000.

Furniture and equipment expense increased $78,000, or 5.9%, including $62,000 from Citizens Trust Company.

Other operating expense increased $58,000, or 1.4%. This category includes many different types of expenses, with significant increases and decreases in some of the individual types of expenses, as follows:

Ø Increase of $201,000 from the acquisition of Citizens Trust Company, including $90,000 for amortization of the core deposit intangible.

Ø Increase of $109,000 from professional and other fees associated with converting First State Bank to the same core computer system as is used by C&N Bank.

Ø Increase of $62,000 in Director fees.

Ø

Increase in miscellaneous taxes of $54,000. Results for 2006 included a reduction in expense related to a sales tax refund.

Ø Increase in computer-related services of $51,000, including services related to a new internet banking platform, branch deposit capture software and an employee time and attendance system.

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- Ø Decrease in certain expense categories for which management has some discretion over spending, including a total reduction of $231,000 in education and training, public relations and donations, office supplies and advertising.

- Ø Decrease in comparative 2007 expense because results for 2006 included a $169,000 impairment write-down related to a leased building which management decided to vacate.

- Ø Decrease in expenses associated with Bucktail Life Insurance Company of $50,000.

- Ø Decrease in expenses associated with other real estate properties of $44,000.

FINANCIAL CONDITION

Significant changes in the average balances of the Corporation s earning assets and interest-bearing liabilities are described in the Net Interest Margin section of Management s Discussion and Analysis. The allowance for loan losses and stockholders equity are discussed in separate sections of Management s Discussion and Analysis.

The Corporation s merger with Citizens Bancorp, Inc. closed on May 1, 2007. On the purchase date, loans increased approximately $60 million, deposits increased approximately $100 million and stockholders equity increased approximately $14 million. Also, intangible assets increased approximately $11 million, and the net impact to the Corporation s balance sheet was a slight reduction in tangible assets as a percentage of tangible equity (tangible assets as a percentage of tangible equity was 10.55% at June 30, 2007 and 11.27% at December 31, 2006). Total capital purchases for 2007, excluding capital assets included in the Citizens Bancorp, Inc. acquisition, are estimated at approximately $2.5-$3 million. In light of the Corporation s strong capital position and ample sources of liquidity, management does not expect the Citizens Bancorp, Inc. acquisition and other capital expenditures to have a material, detrimental effect on the Corporation s financial condition in 2007. Management believes the overall impact on the Corporation s earnings in 2007 and thereafter will depend on the Corporation s ability to build market share and produce profitable results from its investments in new locations, technology and other capital assets, and how long that will take.

PROVISION AND ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained at a level, which, in management s judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management s evaluation of the collectibility of the loan portfolio. In evaluating collectibility, management considers a number of factors, including the status of specific impaired loans, trends in historical loss experience, delinquency trends, credit concentrations, comparison of historical loan loss data to that of other financial institutions and economic conditions within the Corporation s market area. Allowances for impaired loans are determined based on collateral values or the present value of estimated cash flows. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries.

There are two major components of the allowance (1) SFAS 114 allowances on larger loans, mainly commercial purpose, determined on a loan-by-loan basis; and (2) SFAS 5 allowances estimates of losses incurred on the remainder of the portfolio, determined based on collective evaluation of impairment for various categories of loans. SFAS 5 allowances include a portion based on historical net charge-off experience, and a portion based on evaluation of qualitative factors.

Each quarter, management performs a detailed assessment of the allowance and provision for loan losses. A management committee called the Watch List Committee performs this assessment. Quarterly, the Watch List Committee and the applicable Lenders discuss each loan relationship under review, and reach a consensus on the appropriate SFAS 114 estimated loss amount for the quarter. The Watch List Committee s focus is on ensuring all pertinent facts are considered, and that the SFAS 114 loss amounts are reasonable. The assessment includes review of certain loans reported on the Watch List. All loans, which Lenders or the Credit Administration staff has assigned a risk rating of Special Mention, Substandard, Doubtful or Loss, are included in the Watch List. The scope of loans evaluated individually for impairment (SFAS 114 evaluation) include all relationships greater than $200,000 for C&N

Bank loans, and $50,000 for First State Bank, for which there is at least one extension of credit graded Substandard, Doubtful or Loss. Also, relationships less than $200,000 in the aggregate, but with an estimated loss of $100,000 or more, are individually evaluated for impairment.

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The SFAS 5 component of the allowance includes estimates of losses incurred on loans that have not been individually evaluated for impairment. Management uses loan categories included in the Call Report (a quarterly report filed by FDIC-insured banks) to identify categories of loans with similar risk characteristics, and multiplies the loan balances for each category as of each quarter-end by two different factors to determine the SFAS 5 allowance amounts. These two factors are based on: (1) historical net charge-off experience, and (2) qualitative factors. The sum of the allowance amounts calculated for each risk category, including both the amount based on historical net charge-off experience and the amount based on evaluation of qualitative factors, is equal to the total SFAS 5 component of the allowance.

The historical net charge-off portion of the SFAS 5 allowance component is calculated by the Accounting Department as of the end of the applicable quarter. For each loan classification category used in the Call Report, the Accounting Department multiplies the outstanding balance as of the quarter-end (excluding loans individually evaluated for impairment) by the ratio of net charge-offs to average quarterly loan balances for the previous three calendar years. Prior to the fourth quarter 2005, C&N Bank had utilized the ratio of net charge-offs to average balances over a five-year period in calculating the historical loan loss experience portion of the allowance portfolio. Management made the change to the three-year assumption, which had very little effect on the allowance valuation as of December 31, 2005, mainly because management believes net charge-off experience over a 3-year period may be more representative of losses existing in the portfolio as of the balance sheet date.

Effective in the second quarter 2005, management began to calculate the effects of specific qualitative factors criteria to determine a percentage increase or decrease in the SFAS 5 allowance, in relation to the historical net charge-off percentage. The qualitative factors analysis involves assessment of changes in factors affecting the portfolio, to provide for estimated differences between losses currently inherent in the portfolio and the amounts determined based on recent historical loss rates and from identification of losses on specific individual loans. A management committee called the Qualitative Factors Committee meets quarterly, near the end of the final month of each quarter. The Qualitative Factors Committee discusses several qualitative factors, including economic conditions, lending policies, changes in the portfolio, risk profile of the portfolio, competition and regulatory requirements, and other factors, with consideration given to how the factors affect three distinct parts of the loan portfolio: Commercial, Mortgage and Consumer. During or soon after completion of the meeting, each member of the Committee prepares an update to his or her recommended percentage adjustment for each qualitative factor, and average qualitative factor adjustments are calculated for Commercial, Mortgage and Consumer loans. The Accounting Department multiplies the outstanding balance as of the quarter-end (excluding loans individually evaluated for impairment) by the applicable qualitative factor percentages, to determine the portion of the SFAS 5 allowance attributable to qualitative factors.

The allocation of the allowance for loan losses table (Table VIII) includes the SFAS 114 component of the allowance on the line item called Impaired Loans. SFAS 5 estimated losses, including both the portion determined based on historical net charge-off results, as well as the portion based on management s assessment of qualitative factors, are allocated in Table VIII to the applicable categories of commercial, consumer mortgage and consumer loans. In periods prior to 2005, the portion of the allowance determined by management s subjective assessment of economic conditions and other factors (which is now calculated using the qualitative factors criteria described above) was reflected completely in the unallocated component of the allowance. The unallocated portion of the allowance was $434,000 at June 30, 2007, up from $24,000 at December 31, 2006, mainly because of reductions in the portion of the SFAS 5 allowances related to qualitative factors. In the first quarter 2007, the Qualitative Factors Committee decided to lower some of its estimated allowance percentages, mainly in categories related to monitoring the portfolio, based on perceived improvement in identifying and evaluating problem loan relationships on a timely basis. There were only minor changes in qualitative factors in the second quarter 2007.

The allowance for loan losses totaled $8,922,000 at June 30, 2007, up from $8,201,000 at December 31, 2006. As shown in Table VII, the allowance for loan losses recorded as a result of the Citizens Trust Company acquisition was $587,000, which was based on Citizens Trust Company s SFAS 5 allowance at the time of acquisition. Management determined there was no adjustment to the second quarter 2007 provision required as a result of including the Citizens Trust Company loans in the Corporation s allowance calculations. Table VII also shows that net charge-offs in 2007 totaled $95,000, which is low compared to historical levels over the past several years, and much lower than net charge-offs in the first half of 2006 of $599,000. In the second quarter 2006, settlements were reached related to two large commercial loan relationships, resulting in total second quarter 2006 charge-offs related to these two relationships of $568,000. Management expects that net charge-offs may increase in the second half of 2007, depending on the timing and resolution of a few of the large,

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impaired commercial loans discussed in the following paragraph. The provision for loan losses totaled $229,000 in 2007, as compared to $300,000 in the first half of 2006. In the second quarter 2007, the Corporation had no provision for loan losses, while in the second quarter 2006 the Corporation recorded a credit of $300,000. The credit in the second quarter 2006 resulted because the total amount of charge-offs on the large commercial loan relationships referred to above were approximately $450,000 less than the estimated valuation allowance amounts that had been previously recorded. The total amount of the provision for loan losses in each period is determined based on the amount required to maintain an appropriate allowance in light of all of the factors described above.

Table IX presents information related to past due and impaired loans. Total impaired loans amounted to $7,001,000 at June 30, 2007, down from $7,943,000 at March 31, 2007 and $8,011,000 at December 31, 2006. Nonaccrual loans totaled $6,807,000 at June 30, 2007, down from $8,088,000 at March 31, 2007 and $8,506,000 at December 31, 2006. The reduction in impaired and nonaccrual loans at June 30, 2007 resulted mainly from the removal of loans from one commercial relationship from impaired and nonaccrual status. The SFAS 114 valuation allowance on impaired loans totaled $1,734,000 at June 30, 2007, up from $1,615,000 at March 31, 2007 and slightly higher than the total of $1,726,000 at December 31, 2006. The estimated valuation allowance for one commercial relationship was increased $125,000 in the second quarter 2007, with no other significant changes determined by the Watch List Committee. Management believes it has been conservative in its decisions concerning identification of impaired loans, estimates of loss and nonaccrual status. However, the actual losses realized from these relationships could vary materially from the allowances calculated as of June 30, 2007. Management continues to closely monitor its commercial loan relationships for possible credit losses, and will adjust its estimates of loss and decisions concerning nonaccrual status, if appropriate.

Tables VII, VIII, IX and X present an analysis of the allowance for loan losses, the allocation of the allowance, information concerning impaired and past due loans and a five-year summary of loans by type.

TABLE VII ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES
(In Thousands)

	6 Months Ended June 30, 2007	6 Months Ended June 30, 2006	Years Ended December 31, 2006	2005	2004	2003	2002
Balance, beginning of year	$8,201	$8,361	$8,361	$6,787	$6,097	$5,789	$5,265
Charge-offs:							
Real estate loans	30	443	611	264	375	168	123
Installment loans	80	99	259	224	217	326	116
Credit cards and related plans	4	18	22	198	178	171	190
Commercial and other loans	34	171	200	298	16	303	123
Total charge-offs	148	731	1,092	984	786	968	552
Recoveries:							
Real estate loans	4		27	14	3	75	30
Installment loans	22	35	65	61	32	52	30
Credit cards and related plans	7	17	25	30	23	17	18
	20	80	143	50	18	32	58

Commercial and other loans							
Total recoveries	53	132	260	155	76	176	136
Net charge-offs	95	599	832	829	710	792	416
Allowance for loan losses recorded in acquisition	587			377			
Provision for loan losses	229	300	672	2,026	1,400	1,100	940
Balance, end of year	$8,922	$8,062	$8,201	$8,361	$6,787	$6,097	$5,789

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TABLE VIII ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES BY TYPE
(In Thousands)

	As of June 30, 2007	As of December 31, 2006	2005	2004	2003	2002
Commercial	$2,304	$2,372	$2,705	$1,909	$1,578	$1,315
Consumer mortgage	3,812	3,556	2,806	513	456	460
Impaired loans	1,734	1,726	2,374	1,378	1,542	1,877
Consumer	638	523	476	409	404	378
Unallocated	434	24		2,578	2,117	1,759
Total Allowance	$8,922	$8,201	$8,361	$6,787	$6,097	$5,789

TABLE IX PAST DUE AND IMPAIRED LOANS
(In Thousands)

	As of June 30, 2007	As of March 31, 2007	As of December 31, 2006	2005	2004	2003	2002
Impaired loans without a valuation allowance	$1,690	$2,578	$2,674	$ 910	$3,552	$ 114	$ 675
Impaired loans with a valuation allowance	5,311	5,365	5,337	7,306	4,709	4,507	3,039
Total impaired loans	$7,001	$7,943	$8,011	$8,216	$8,261	$4,621	$3,714
Valuation allowance related to impaired loans	$1,734	$1,615	$1,726	$2,374	$1,378	$1,542	$1,877
Total nonaccrual loans	$6,807	$8,088	$8,506	$6,365	$7,796	$1,145	$1,252
Total loans past due 90 days or more and still accruing	$ 968	$ 844	$1,559	$1,369	$1,307	$2,546	$2,318

TABLE X SUMMARY OF LOANS BY TYPE
(In Thousands)

	June 30, 2007	As of December 31, 2006	2005	2004	2003	2002
Real estate construction	$ 12,851	$ 10,365	$ 5,552	$ 4,178	$ 2,856	$ 103
	434,341	387,410	361,857	347,705	330,807	292,136

Real estate residential mortgage						
Real estate commercial mortgage	160,478	178,260	153,661	128,073	100,240	78,317
Consumer	43,651	35,992	31,559	31,702	33,977	31,532
Agricultural	3,412	2,705	2,340	2,872	2,948	3,024
Commercial	53,490	39,135	69,396	43,566	34,967	30,874
Other	1,099	1,227	1,871	1,804	1,183	2,001
Political subdivisions	46,714	32,407	27,063	19,713	17,854	13,062
Lease receivables					65	96
Total	756,036	687,501	653,299	579,613	524,897	451,145
Less: allowance for loan losses	(8,922)	(8,201)	(8,361)	(6,787)	(6,097)	(5,789)
Loans, net	$747,114	$679,300	$644,938	$572,826	$518,800	$445,356

DERIVATIVE FINANCIAL INSTRUMENTS

The Corporation has utilized derivative financial instruments related to a certificate of deposit product called the Index Powered Certificate of Deposit (IPCD). IPCDs have a term of 5 years, with interest paid at maturity based on 90% of the appreciation (as defined) in the S&P 500 index. There is no guaranteed interest payable to a depositor of an IPCD however, assuming an IPCD is held to maturity, a depositor is guaranteed the return of his or her principal, at a minimum. In 2004, the Corporation stopped originating new IPCDs, but continues to maintain and account for IPCDs and the related derivative contracts entered into between 2001 and 2004.

Statement of Financial Accounting Standards No. 133 requires the Corporation to separate the amount received from each IPCD issued into 2 components: (1) an embedded derivative, and (2) the principal amount of each

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deposit. Embedded derivatives are derived from the Corporation s obligation to pay each IPCD depositor a return based on appreciation in the S&P 500 index. Embedded derivatives are carried at fair value, and are included in other liabilities in the consolidated balance sheet. Changes in fair value of the embedded derivative are included in other expense in the consolidated income statement. The difference between the contractual amount of each IPCD issued, and the amount of the embedded derivative, is recorded as the initial deposit (included in interest-bearing deposits in the consolidated balance sheet). Interest expense is added to principal ratably over the term of each IPCD at an effective interest rate that will increase the principal balance to equal the contractual IPCD amount at maturity.

In connection with IPCD transactions, the Corporation has entered into Equity Indexed Call Option (Swap) contracts with the Federal Home Loan Bank of Pittsburgh (FHLB-Pittsburgh). Under the terms of the Swap contracts, the Corporation must pay FHLB-Pittsburgh quarterly amounts calculated based on the contractual amount of IPCDs issued times a negotiated rate. In return, FHLB-Pittsburgh is obligated to pay the Corporation, at the time of maturity of the IPCDs, an amount equal to 90% of the appreciation (as defined) in the S&P 500 index. If the S&P 500 index does not appreciate over the term of the related IPCDs, the FHLB-Pittsburgh would make no payment to the Corporation. The effect of the Swap contracts is to limit the Corporation s cost of IPCD funds to the market rate of interest paid to FHLB-Pittsburgh. (In addition, the Corporation paid a fee of 0.75% to a consulting firm at inception of each deposit. These fees are being amortized to interest expense over the term of the IPCDs.) Swap assets or liabilities are carried at fair value, and included in other assets or other liabilities in the consolidated balance sheet. Changes in fair value of swap liabilities are included in other expense in the consolidated income statement.

The impact to the income statement for 2007 and 2006 from IPCDs is not significant. Balance sheet amounts as of June 30, 2007 and December 31, 2006 related to IPCDs are as follows (in thousands):

	June 30, 2007	**Dec. 31, 2006**
Contractual amount of IPCDs (equal to notional amount of Swap contracts)	$1,517	$2,516
Carrying value of IPCDs	1,477	2,444
Carrying value of embedded derivative liabilities	550	610
Carrying value of Swap contract (asets) liabilities	(504)	(528)

LIQUIDITY

Liquidity is the ability to quickly raise cash at a reasonable cost. An adequate liquidity position permits the Corporation to pay creditors, compensate for unforeseen deposit fluctuations and fund unexpected loan demand. The Corporation maintains overnight borrowing facilities with several correspondent banks that provide a source of day-to-day liquidity. Also, the Corporation maintains borrowing facilities with FHLB Pittsburgh, secured by mortgage loans and various investment securities. At June 30, 2007, the Corporation had unused borrowing availability with correspondent banks and the Federal Home Loan Bank of Pittsburgh totaling approximately $236,000,000. Additionally, the Corporation uses repurchase agreements placed with brokers to borrow funds secured by investment assets, and uses RepoSweep arrangements to borrow funds from commercial banking customers on an overnight basis. Further, if required to raise cash in an emergency situation, the Corporation could sell non-pledged investment securities to meet its obligations. At June 30, 2007, the carrying value of non-pledged available-for-sale securities was $120,548,000.

Management believes the combination of its strong capital position (discussed in the next section), ample available borrowing facilities and substantial non-pledged securities portfolio have placed the Corporation in a position of minimal short-term and long-term liquidity risk.

STOCKHOLDERS EQUITY AND CAPITAL ADEQUACY

The Corporation and the subsidiary banks (Citizens & Northern Bank and First State Bank) are subject to various regulatory capital requirements administered by the federal banking agencies. The Corporation s estimated, consolidated capital ratios at June 30, 2007 are as follows:

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Total capital to risk-weighted assets	16.58%
Tier 1 capital to risk-weighted assets	15.34%
Tier 1 capital to average total assets	11.36%

Management expects the Corporation and the subsidiary banks to maintain capital levels that exceed the regulatory standards for well-capitalized institutions for the next 12 months and for the foreseeable future. Planned capital expenditures are not expected to have a significantly detrimental effect on capital ratios.

The Corporation s total stockholders equity is affected by fluctuations in the fair values of available-for-sale securities. The difference between amortized cost and fair value of available-for-sale securities, net of deferred income tax, is included in Accumulated Other Comprehensive Income within stockholders equity. Changes in accumulated other comprehensive income are excluded from earnings and directly increase or decrease stockholders equity.

The balance in accumulated other comprehensive income related to unrealized losses on available-for-sale securities, net of deferred income tax, amounted to a negative balance of $636,000 at June 30, 2007, down from a positive balance resulting from net unrealized gains of $1,794,000 at December 31, 2006. The decrease in accumulated other comprehensive income in 2007 resulted mainly from increases in long-term interest rates, which caused declines in market values of debt securities.

Effective December 31, 2006, the Corporation applied SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS No. 158 requires the Corporation to recognize the underfunded or overfunded status of defined benefit pension and postretirement plans as a liability or asset in the balance sheet. The Corporation has recognized a liability for the underfunded balance of its defined benefit pension and postretirement plans, and has recognized a reduction in stockholders equity (included in accumulated other comprehensive income) for the amount of the liability, net of deferred income tax. Accumulated other comprehensive income included a negative balance of $1,168,000 at June 30, 2007 and $1,181,000 at December 31, 2006 related to SFAS 158.

INFLATION

The Corporation is significantly affected by the Federal Reserve Board s efforts to control inflation through changes in short-term interest rates. From mid-2004 through mid-2006, the Federal Reserve Board increased the Fed funds target rate 15 times from a low of 1% to its current level of 5.25%. Since mid-2004, long-term interest rates have not increased nearly as much as short-term rates, which has hurt the Corporation s profitability by squeezing the net interest margin. Although management cannot predict future changes in the rate of inflation, management monitors the impact of economic trends, including any indicators of inflationary pressure, in managing interest rate and other financial risks.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (Interpretation 48). Interpretation 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement 109, Accounting for Income Taxes. Interpretation 48 is effective for the year ended December 31, 2007. The Corporation does not expect the adoption of this pronouncement to have a material effect on its financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), to establish a consistent framework for measuring fair value and expand disclosures on fair value measurements. The provisions of SFAS 157 are effective beginning in 2008 and are currently not expected to have a material effect on the Corporation s financial statements.

In February 2007, FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective as of

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the beginning of an entity s first fiscal year that begins after November 15, 2007 (the Corporation s 2008 fiscal year). The Corporation considered early adoption of SFAS 159, effective as of January 1, 2007, but decided not to make that early adoption. The Corporation is currently evaluating the potential impact of the adoption of this pronouncement on its 2008 consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

The Corporation s two major categories of market risk, interest rate risk and equity securities risk, are discussed in the following sections.

INTEREST RATE RISK

Business risk arising from changes in interest rates is a significant factor in operating a bank. The Corporation s assets are predominantly long-term, fixed rate loans and debt securities. Funding for these assets comes principally from short-term deposits and borrowed funds. Accordingly, there is an inherent risk of lower future earnings or decline in fair value of the Corporation s financial instruments when interest rates change.

Citizens & Northern Bank uses a simulation model to calculate the potential effects of interest rate fluctuations on net interest income and the market value of portfolio equity. Only assets and liabilities of Citizens & Northern Bank are included in management s monthly simulation model calculations. Since Citizens & Northern Bank makes up more than 90% of the Corporation s total assets and liabilities, and because Citizens & Northern Bank is the source of the most volatile interest rate risk, presently management does not consider it necessary to run the model for the remaining entities within the consolidated group. (Management intends to add First State Bank s data to the model, beginning later in 2007.) For purposes of these calculations, the market value of portfolio equity includes the fair values of financial instruments, such as securities, loans, deposits and borrowed funds, and the book values of nonfinancial assets and liabilities, such as premises and equipment and accrued expenses. The model measures and projects potential changes in net interest income, and calculates the discounted present value of anticipated cash flows of financial instruments, assuming an immediate increase or decrease in interest rates. Management ordinarily runs a variety of scenarios within a range of plus or minus 50-300 basis points of current rates.

Citizens & Northern Bank s Board of Directors has established policy guidelines for acceptable levels of interest rate risk, based on an immediate increase or decrease in interest rates. Citizens & Northern Bank s policy provides limits at +/- 100, 200 and 300 basis points from current rates for fluctuations in net interest income from the baseline (flat rates) one-year scenario. The policy also limits acceptable market value variances from the baseline values based on current rates. As Table XI shows, as of June 30, 2007 and December 31, 2006, the decline in net interest income exceeds the policy threshold marks if interest rates were to immediately rise by 200 or 300 basis points, and the decline in market value exceeds the policy threshold marks if interest rates were to rise immediately by 300 basis points. The out of policy positions are a reflection of the Corporation s liability sensitive position (on average, deposits and borrowings reprice more quickly than loans and debt securities). Management used the simulation model to estimate the effect of the securities restructuring transaction (described in the Earnings Overview section of Management s Discussion and Analysis) on net interest income and market value in rising and falling rate scenarios, and the model showed that although net interest income would be expected to increase over the next 12 months in all scenarios, the change in volatility of net interest income and market value of portfolio equity would be slight. Management has reviewed these positions with the Board of Directors at quarterly or monthly intervals throughout 2006 and as of June 30, 2007. In addition, management will continue to evaluate whether to make any changes to asset or liability holdings in an effort to reduce exposure to rising interest rates.

The table that follows was prepared using the simulation model described above. The model makes estimates, at each level of interest rate change, regarding cash flows from principal repayments on loans and mortgage-backed securities and call activity on other investment securities. Actual results could vary significantly from these estimates, which could result in significant differences in the calculations of projected changes in net interest margin and market value of portfolio equity. Also, the model does not make estimates related to changes in the composition of the deposit portfolio that could occur due to rate competition and the table does not necessarily reflect changes that management would make to realign the portfolio as a result of changes in interest rates.

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TABLE XI THE EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES
June 30, 2007 Data
(In Thousands)

	Period Ending June 30, 2008				
Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+300	$77,408	$51,692	$25,716	-25.1%	20.0%
+200	75,063	46,358	28,705	-16.3%	15.0%
+100	72,625	41,025	31,600	-7.9%	10.0%
0	70,066	35,753	34,313	0.0%	0.0%
-100	67,009	30,576	36,433	6.2%	10.0%
-200	63,329	25,804	37,525	9.4%	15.0%
-300	59,212	21,716	37,496	9.3%	20.0%

	Market Value of Portfolio Equity at June 30, 2007		
Basis Point Change in Rates	Present Value Equity	Present Value % Change	Present Value Risk Limit
+300	$ 66,998	-49.6%	45.0%
+200	89,337	-32.8%	35.0%
+100	111,929	-15.8%	25.0%
0	132,857	0.0%	0.0%
-100	150,337	13.2%	25.0%
-200	160,938	21.1%	35.0%
-300	168,129	26.5%	45.0%

December 31, 2006 Data
(In Thousands)

	Period Ending December 31, 2007				
Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+300	$69,054	$47,384	$21,670	-27.6%	20.0%
+200	67,143	42,650	24,493	-18.1%	15.0%
+100	65,185	37,917	27,268	-8.9%	10.0%
0	63,105	33,184	29,921	0.0%	0.0%
-100	60,376	28,552	31,824	6.4%	10.0%
-200	57,077	24,438	32,639	9.1%	15.0%
-300	53,469	20,935	32,534	8.7%	20.0%

	Market Value of Portfolio Equity at December 31, 2006		
	Present Value	Present Value	Present Value

Basis Point Change in Rates	Equity	% Change	Risk Limit
+300	$ 49,927	-58.2%	45.0%
+200	72,979	-38.9%	35.0%
+100	96,660	-19.1%	25.0%
0	119,522	0.0%	0.0%
-100	136,579	14.3%	25.0%
-200	146,645	22.7%	35.0%
-300	156,384	30.8%	45.0%

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EQUITY SECURITIES RISK

The Corporation s equity securities portfolio consists primarily of investments in stock of banks and bank holding companies located mainly in Pennsylvania. The Corporation also owns some other stocks and mutual funds. Investments in bank stocks are subject to the risk factors that affect the banking industry in general, including competition from non-bank entities, credit risk, interest rate risk and other factors, which could result in a decline in market prices. Also, losses could occur in individual stocks held by the Corporation because of specific circumstances related to each bank. Further, because of the concentration of bank and bank holding companies located in Pennsylvania, these investments could decline in market value if there is a downturn in the state s economy.

Equity securities held as of June 30, 2007 and December 31, 2006 are presented in Table XII.

TABLE XII EQUITY SECURITIES
(In Thousands)

At June 30, 2007	Cost	Fair Value	Hypothetical 10% Decline In Market Value	Hypothetical 20% Decline In Market Value
Banks and bank holding companies	$19,485	$22,474	$(2,247)	$(4,495)
Other equity securities	2,557	2,991	(299)	(598)
Total	$22,042	$25,465	$(2,546)	$(5,093)

At December 31, 2006	Cost	Fair Value	Hypothetical 10% Decline In Market Value	Hypothetical 20% Decline In Market Value
Banks and bank holding companies	$19,884	$26,008	$(2,601)	$(5,202)
Other equity securities	4,146	4,704	(470)	(941)
Total	$24,030	$30,712	$(3,071)	$(6,143)

ITEM 4. CONTROLS AND PROCEDURES

The Corporation s management, under the supervision of and with the participation of the Corporation s Chief Executive Officer and Chief Financial Officer, has carried out an evaluation of the design and effectiveness of the Corporation s disclosure controls and procedures as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Securities Exchange Act of 1934 as of the end of period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Corporation s disclosure controls and procedures are effective to ensure that all material information required to be disclosed in reports the Corporation files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms.

There were no significant changes in the Corporation s internal control over financial reporting that occurred during the period covered by this report that has materially affected, or that is reasonably likely to affect, our internal control over financial reporting.

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PART II OTHER INFORMATION
Item 1. Legal Proceedings

The Corporation and the subsidiary banks are involved in various legal proceedings incidental to their business. Management believes the aggregate liability, if any, resulting from such pending and threatened legal proceedings will not have a material, adverse effect on the Corporation s financial condition or results of operations.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Item 1A of the Corporation s Form 10-K filed March 2, 2007.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

c. Issuer Purchases of Equity Securities

On August 24, 2006, the Corporation announced the extension of a plan that permits the repurchase of shares of its outstanding common stock, up to an aggregate total of $13 million, through August 31, 2007. The Board of Directors authorized repurchase from time to time at prevailing market prices in open market or in privately negotiated transactions as, in management s sole opinion, market conditions warrant and based on stock availability, price and the Company s financial performance. As of June 30, 2007, the maximum additional value available for purchases under this program is $10,073,917.

The following table sets forth a summary of the purchases by the Corporation, on the open market, of its equity securities for the second quarter 2007:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
April 1 - 30, 2007		$		$ 10,263,277
May 1 - 31, 2007	9,000	$ 21.04	9,000	$ 10,073,917
June 1 - 30, 2007		$		$ 10,073,917

Item 3. Defaults Upon Senior Securities

None

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

The Annual Meeting of Shareholders of Citizens & Northern Corporation was held on Tuesday, April 17, 2007. The Board of Directors fixed the close of business on February 27, 2007 as the record date for the determination of stockholders entitled to notice of and to vote at the Annual Meeting and at any adjournment thereof. On this record date, there were outstanding and entitled to vote 8,292,759 shares of Common Stock.

The total number of votes cast was 5,995,205, including 360,288 voted in person by owners or representatives and 5,634,917 voted by proxy. The only issue voted on was election of one Class I Director and five Class II Directors, with the following results:

Raymond R. Mattie	
Total Votes in Favor	5,725,411

Total Votes Withheld	269,786

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R. Bruce Haner	
Total Votes in Favor	5,727,470
Total Votes Withheld	267,728
Susan E. Hartley	
Total Votes in Favor	5,708,542
Total Votes Withheld	286,655
Leo L. Lambert	
Total Votes in Favor	5,683,222
Total Votes Withheld	311,976
Edward L. Learn	
Total Votes in Favor	5,724,501
Total Votes Withheld	270,696
Leonard Simpson	
Total Votes in Favor	5,726,684
Total Votes Withheld	268,514

There were 353,078 shares non-voted by brokers related to the election of the Class I and Class II Directors noted above.

Item 5. Other Information

None

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Item 6. Exhibits

2. Plan of acquisition, reorganization, arrangement, liquidation or succession	Incorporated by reference to Annex A in Form S-4/A filed on March 6, 2007, and for which Notice of Effectiveness was received March 8, 2007
3. (i) Articles of Incorporation	Incorporated by reference to Exhibit 4.1 to the Corporation s Form S-8 registration statement filed November 3, 2006
3. (ii) By-laws	Incorporated by reference to Exhibit 3.1 of the Corporation s Form 8-K filed August 25, 2004
4. Instruments defining the rights of security holders, including indentures	Not applicable
10. Material contracts	Not applicable
11. Statement re: computation of per share earnings	Information concerning the computation of earnings per share is provided in Note 2 to the Consolidated Financial Statements, which is included in Part I, Item 1 of Form 10-Q.
15. Letter re: unaudited financial information	Not applicable
18. Letter re: change in accounting principles	Not applicable
19. Report furnished to security holders	Not applicable
20. Other documents or statements to security holders	Not applicable
22. Published report regarding matters submitted to vote of security holders	Not applicable
23. Consents of experts and counsel	Not applicable
24. Power of attorney	Not applicable
31. Rule 13a-14(a)/15d-14(a) certifications:	
31.1 Certification of Chief Executive Officer	Filed herewith
31.2 Certification of Chief Financial Officer	Filed herewith
32. Section 1350 certifications	Filed herewith
99. Additional exhibits	Not applicable

100. XBRL-related documents	Not applicable

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Signature Page

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	CITIZENS & NORTHERN CORPORATION
August 8, 2007	By: /s/ Craig G. Litchfield
	Chairman, President and Chief Executive Officer
August 8, 2007	By: /s/ Mark A. Hughes
Date	Treasurer and Chief Financial Officer

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