ORRSTOWN FINANCIAL SERVICES INC
Form 10-Q
November 07, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10 - Q

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2007

Or

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

Commission File Number 33-18888

ORRSTOWN FINANCIAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

Commonwealth of Pennsylvania	**23-2530374**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
77 East King Street, P.O. Box 250, Shippensburg, Pennsylvania	**17257**

(Address of principal executive offices) **(Zip Code)**

(717) 532-6114

(Registrant s telephone number, including area code)

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b 2 of the Exchange Act). YES ¨ NO x

As of September 30, 2007, 6,421,302 shares of common stock, no par value, of the registrant were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements
ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)	(Unaudited) September 30, 2007	(Audited) * December 31, 2006
ASSETS		
Cash and due from banks	$ 14,769	$ 20,730
Federal funds sold	6,530	18,404
Cash and cash equivalents	21,299	39,134
Interest bearing deposits with banks	393	895
Member stock, at cost which approximates market value	4,706	3,850
Securities available for sale	98,034	87,543
Loans	684,430	618,827
Allowance for loan losses	(5,643)	(5,520)
Net Loans	678,787	613,307
Premises and equipment, net	22,217	19,852
Goodwill and intangible assets	21,430	21,567
Cash surrender value of life insurance	15,873	15,573
Accrued interest receivable	3,536	3,279
Other assets	5,838	4,031
Total assets	$ 872,113	$ 809,031
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Non-interest bearing	$ 87,152	$ 85,420
Interest bearing	571,719	553,299
Total deposits	658,871	638,719
Short term borrowings	59,804	41,703
Long term debt	52,250	32,440
Accrued interest payable	1,045	1,111
Other liabilities	5,877	5,670
Total liabilities	777,847	719,643
Common stock, no par value - $ .05205 stated value per share; 50,000,000 shares authorized; 6,452,676 and 6,145,049 shares issued	336	320
Additional paid - in capital	82,515	72,023
Retained earnings	12,169	16,934
Accumulated other comprehensive income	333	507
Treasury stock, 31,374 and 10,717 shares, at cost	(1,087)	(396)
Total shareholders equity	94,266	89,388

Total liabilities and shareholders equity	$ 872,113	$ 809,031

* Condensed from audited financial statements
The accompanying notes are an integral part of these condensed financial statements.

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ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended	
(Dollars in Thousands)	**September 2007**	**September 2006**
INTEREST INCOME		
Interest and fees on loans	$ 12,481	$ 10,902
Interest and dividends on investment securities	1,020	1,031
Interest on short term investments	155	341
Total interest income	13,656	12,274
INTEREST EXPENSE		
Interest on deposits	4,924	4,083
Interest on short-term borrowings	642	558
Interest on long-term debt	405	274
Total interest expense	5,971	4,915
Net interest income	7,685	7,359
Provision for loan losses	90	36
Net interest income after provision for loan losses	7,595	7,323
OTHER INCOME		
Service charges on deposits	1,577	1,335
Other service charges	565	418
Trust department income	688	573
Brokerage income	452	323
Other income	253	140
Securities gains / (losses)	(12)	27
Total other income	3,523	2,816
OTHER EXPENSES		
Salaries and employee benefits	3,751	3,508
Occupancy and equipment	906	868
Data processing	239	239
Advertising	92	102
Other operating expense	1,232	1,148
Total other expense	6,220	5,865
Income before income taxes	4,898	4,274
Income tax expense	1,471	1,270
Net income	$ 3,427	$ 3,004
PER SHARE DATA		
Basic earnings per share	$ 0.53	$ 0.46
Diluted earnings per share	$ 0.51	$ 0.44

Dividends per share	$ 0.21	$ 0.19

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

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ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Nine Months Ended	
(Dollars in Thousands)	**September 2007**	**September 2006**
INTEREST INCOME		
Interest and fees on loans	$ 35,679	$ 28,675
Interest and dividends on investment securities	3,000	2,721
Interest on short term investments	556	803
Total interest income	39,235	32,199
INTEREST EXPENSE		
Interest on deposits	14,092	9,781
Interest on short-term borrowings	1,722	1,330
Interest on long-term debt	1,216	990
Total interest expense	17,030	12,101
Net interest income	22,205	20,098
Provision for loan losses	240	108
Net interest income after provision for loan losses	21,965	19,990
OTHER INCOME		
Service charges on deposits	4,198	3,408
Other service charges	1,605	1,436
Trust department income	1,946	1,747
Brokerage income	1,191	976
Other income	620	451
Non-recurring revenue	219	0
Securities gains / (losses)	58	39
Total other income	9,837	8,057
OTHER EXPENSES		
Salaries and employee benefits	11,043	9,512
Occupancy and equipment	2,701	2,438
Data processing	657	671
Advertising	278	301
Non-recurring expense	78	0
Other operating expense	3,557	2,841
Total other expense	18,314	15,763
Income before income taxes	13,488	12,284
Income tax expense	3,978	3,636
Net income	$ 9,510	$ 8,648

PER SHARE DATA

Basic earnings per share	$	1.48	$	1.41
Diluted earnings per share	$	1.41	$	1.35
Dividends per share	$	0.61	$	0.552

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

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ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in Thousands)	**Three Months Ended September 2007**	**Three Months Ended September 2006**
COMPREHENSIVE INCOME		
Net Income	$ 3,427	$ 3,004
Other comprehensive income, net of tax		
Unrealized gain (loss) on investment securities available for sale	314	695
Comprehensive Income	$ 3,741	$ 3,699

(Dollars in Thousands)	**Nine Months Ended September 2007**	**Nine Months Ended September 2006**
COMPREHENSIVE INCOME		
Net Income	$ 9,510	$ 8,648
Other comprehensive income, net of tax		
Unrealized gain (loss) on investment securities available for sale	(174)	163
Comprehensive Income	$ 9,336	$ 8,811

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

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ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in Thousands)	Nine Months Ended September 2007	Nine Months Ended September 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 9,510	$ 8,648
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,377	1,260
Provision for loan losses	240	108
Other, net	(784)	172
Net cash provided by operating activities	10,343	10,188
CASH FLOWS FROM INVESTING ACTIVITIES		
Net decrease in interest bearing deposits with banks	502	3,300
Purchases of available for sale securities	(27,085)	(4,963)
Sales and maturities of available for sale securities	16,276	10,595
Purchase of intangible assets	51	0
Net (increase) in loans	(65,720)	(71,744)
Purchases of bank premises and equipment	(4,516)	(2,203)
Purchase price of shares exchanged for cash	0	(8,882)
Cash acquired in acquisition	0	13,031
Other, net	(1,131)	657
Net cash (used) by investing activities	(81,623)	(60,209)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	20,152	56,817
Dividends paid	(3,922)	(3,435)
Proceeds from issuance of common stock	17	135
Purchase of treasury stock	(764)	(543)
Net proceeds from issuance of treasury stock	74	0
Net change in short-term borrowings	18,101	6,582
Proceeds from long-term borrowings	28,000	0
Repayment of long-term borrowings	(8,190)	(17,668)
Other, net	(23)	224
Net cash provided by financing activities	53,445	42,112
Net (decrease) in cash and cash equivalents	(17,835)	(7,909)
Cash and cash equivalents at beginning of period	39,134	35,331
Cash and cash equivalents at end of period	$ 21,299	$ 27,422
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 17,096	$ 11,789
Income Taxes	4,050	3,775
Supplemental schedule of noncash investing and financing activities:		

Unrealized gain (loss) on investments available for sale (net of deferred taxes of $(98) and $ 84 at September 30, 2007 and 2006, respectively)	(174)	163

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

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ORRSTOWN FINANCIAL SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2007

Note 1: Summary of Significant Accounting Policies

Basis of Presentation

The unaudited financial statements of Orrstown Financial Services, Inc. (the Corporation or Orrstown) and its subsidiary are presented at and for the three and nine months ended September 30, 2007 and 2006 and have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. However, unaudited 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 period. Information presented at December 31, 2006 is condensed from audited year-end financial statements. For further information, refer to the audited consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-K for the year ended December 31, 2006.

Operating

Orrstown Financial Services, Inc. is a financial holding company including its wholly-owned subsidiary, Orrstown Bank. As of the close of business on June 15, 2007, Orrstown Bank and The First National Bank of Newport (First National) collapsed the two banks charters into one bank with Orrstown Bank as the surviving bank. All significant intercompany transactions and accounts have been eliminated.

Operating results for the three and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Cash Flows

For purposes of the Statements of Cash Flows, cash and cash equivalents include Cash and due from banks and Federal funds sold. As permitted by Statement of Financial Accounting Standards No. 104, the Corporation has elected to present the net increase or decrease in deposits with banks, loans and deposits in the Statement of Cash Flows.

Federal Income Taxes

For financial reporting purposes, the provision for loan losses charged to operating expense is based on management s judgment, whereas for federal income tax purposes the amount allowable under present tax law is deducted. Additionally, deferred compensation is charged to operating expense in the period the liability is incurred for financial reporting purposes, whereas for federal income tax purposes these expenses are deducted when paid. As a result of the aforementioned timing differences plus the timing differences associated with depreciation expense, deferred income taxes are provided in the financial statements. Income tax expense is less than the amount calculated using the statutory tax rate primarily as a result of tax exempt income earned from state and political subdivision obligations.

Investment Securities

Management determines the appropriate classification of securities at the time of purchase. If management has the intent and the Corporation has the ability at the time of purchase to hold securities until maturity, they are classified as securities held to maturity and carried at amortized historical cost. Securities to be held for indefinite periods of time, and not intended to be held to maturity, are classified as available for sale and carried at fair value. Securities held for indefinite periods of time include securities that management intends to use as part of its asset and liability management strategy and that may be sold in response to changes in interest rates, resultant prepayment risk, and other factors related to interest rate and resultant prepayment risk changes.

Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value of the securities sold, using the specific identification method. Unrealized gains and losses on investment securities available for sale are based on the difference between book value and fair value of each security. These gains and losses are credited or charged to other comprehensive income, whereas realized gains and losses flow through the Corporation s results of operations.

The Corporation has classified all investment securities as available for sale . At December 31, 2006, fair value exceeded amortized cost by $390,000 and at September 30, 2007 fair value exceeded amortized cost by $509,000. In shareholders equity, the balance of accumulated other comprehensive income decreased to $333,000 from $507,000 at December 31, 2006.

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Stock-Based Compensation

The Corporation maintains two stock-based compensation plans. These plans provide for the granting of stock options to the Corporation s directors and the Bank s employees. FAS Statement No 123R, Share-Based Payment requires financial statement recognition of compensation cost for stock options and other stock-based awards. Both of the Corporation s stock-based compensation plans are fully vested when granted and, therefore, are expensed on the date of grant using the Black-Scholes option-pricing model.

Earnings per share of common stock

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect the addition of an incremental number of shares added as a result of converting common stock equivalents. A reconciliation of the weighted average shares outstanding used to calculate basic net income per share and diluted net income per share follows. There is no adjustment to net income to arrive at diluted net income per share.

Earnings per share for the three and nine months ended September 30, have been computed as follows:

	Three Months Ended		Nine Months Ended	
(In Thousands, except per share data)	**September 2007**	**September 2006**	**September 2007**	**September 2006**
Net Income	$ 3,427	$ 3,004	$ 9,510	$ 8,648
Weighted average shares outstanding (basic)	6,424	6,441	6,431	6,122
Impact of common stock equivalents	322	289	300	269
Weighted average shares outstanding (diluted)	6,746	6,730	6,731	6,391
Per share information:				
Basic earnings per share	$ 0.53	$ 0.46	$ 1.48	$ 1.41
Diluted earnings per share	$ 0.51	$ 0.44	$ 1.41	$ 1.35

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 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with SFAS 109. The Interpretation prescribes a recognition threshold and measurement principles for the financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. The implementation of FIN 48 has not had a material impact on the Corporation s financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but may change current practice for some entities. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The Corporation does not expect the implementation of SFAS 157 to have a material impact on its financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. The fair value option established by this SFAS permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This SFAS is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the fiscal year that begins before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157, Fair Value Measurement. The Corporation has decided not to adopt SFAS No. 159 early.

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Note 2: Other Commitments

In the normal course of business, the bank makes various commitments and incurs certain contingent liabilities which are not reflected in the accompanying financial statements. These commitments include various guarantees and commitments to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Corporation s subsidiary bank evaluates each customer s credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management s credit evaluation of the customer. Standby letters of credit and financial guarantees written are conditional commitments to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The bank holds collateral supporting those commitments when deemed necessary by management. As of September 30, 2007, $26,735,000 of performance standby letters of credit have been issued. The Corporation does not anticipate any losses as a result of these transactions.

Note 3: Changes in Common Stock

On April 26, 2007, the Board of Directors of Orrstown Financial Services, Inc. approved a 5% stock dividend, payable on June 15, 2007 to shareholders of record on May 25, 2007. Under this stock dividend, shareholders received one additional share of common stock for every twenty shares owned as of the record date. Fractional shares were paid in cash. All per share amounts have been adjusted to give retroactive recognition to the 5% stock dividend.

Note 4: Subsequent Event

On October 29, 2007, Orrstown Financial Services, Inc. announced the purchase of a facility to utilize as its Operations Center. The Bank has concluded its purchase of the Norland Business Park located at 2605 - 2695 Philadelphia Avenue, Chambersburg, Pennsylvania. The facility previously housed a multi unit shopping center. The Bank plans to utilize a large portion of the facility as its Operations Center with some space available for lease. The initial outlay required was $3.2 million. Renovations to the existing building will be needed and are expected to be completed by March of 2008.

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PART I FINANCIAL INFORMATION

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

Orrstown Financial Services, Inc. (the Corporation) is a financial holding company with a wholly-owned bank subsidiary, Orrstown Bank. On May 1, 2006, Orrstown Financial Services, Inc. completed the acquisition of The First National Bank of Newport (First National); therefore, First National is not included in the first four months of results in 2006. During January 2007, both bank boards executed documents allowing the collapse of the two banks charters into one bank. The consolidation of the companies took place as of the close of business on June 15, 2007.

The following is a discussion of our consolidated financial condition at September 30, 2007 and results of operations for the three and nine months ended September 30, 2007 and three and nine months ended September 30, 2006. Throughout this discussion, the yield on earning assets is stated on a fully taxable-equivalent basis and balances represent average daily balances unless otherwise stated.

Some statements and information may contain forward-looking statements. Factors that could cause actual results to differ materially from forward-looking statements include, but are not limited to: general political and economic conditions, unforeseen changes in the general interest rate environment, developments concerning credit quality in various corporate lending industry sectors, legislative or regulatory developments, legal proceedings, and pending or proposed changes in accounting rules, policies, practices, and procedures. Each of these factors could affect estimates and assumptions used to produce forward looking statements causing actual results to differ materially from those anticipated. Future results could also differ materially from historical performance.

Critical Accounting Policies

The Bank policy related to the allowance for loan losses is considered to be a critical accounting policy because the allowance for loan losses represents a particularly sensitive accounting estimate. The amount of the allowance is based on management s evaluation of the collectibility of the loan portfolio, including the nature of the loan portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, grouping of like loans, grading of individual loan quality, review of specific problem loans, the examination of underlying collateral and current economic conditions that may affect the borrowers ability to pay.

SUMMARY OF FINANCIAL RESULTS

Orrstown Financial Services, Inc. recorded net income of $3,427,000 for the third quarter of 2007 compared to $3,004,000 for the same period in 2006, representing an increase of $423,000 or 14.1%. Basic earnings per share (EPS) increased $0.07 to $0.53 in the recent quarter from the $0.46 earned during the third quarter of 2006. Diluted earnings per share for the third quarter were $0.51 versus $0.44 last year.

Net income for the first nine months of 2007 was $9,510,000 compared to $8,648,000 for the same period in 2006, representing an increase of $862,000 or 10.0%. Basic earnings per share for the first nine months of 2007 increased $0.07 to $1.48 from $1.41 for the same period last year. Diluted earnings per share for the first nine months were $1.41 versus $1.35 last year. All per share amounts have been restated to reflect the 5% stock dividend paid to shareholders on June 15, 2007.

Included below are ratios for the return on average tangible assets (ROTA) and return on average tangible equity (ROTE) which exclude intangibles from the balance sheet and related amortization and tax expense from net income due to the associated goodwill and intangibles from the acquisition of First National and the acquisition of other investment companies and purchased deposits.

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The following statistics compare the third quarter and year-to-date performance of 2007 to that of 2006:

	Three Months Ended		Nine Months Ended	
	September 2007	September 2006	September 2007	September 2006
Return on average assets	1.61%	1.52%	1.54%	1.66%
Return on average tangible assets	1.67%	1.58%	1.60%	1.71%
Return on average equity	14.70%	13.92%	13.95%	15.77%
Return on average tangible equity	19.36%	18.89%	18.49%	19.33%
Average equity / Average assets	10.94%	10.92%	11.04%	10.52%

RESULTS OF OPERATIONS

Quarter ended September 30, 2007 compared to Quarter ended September 30, 2006

Net interest income for the third quarter of 2007 was $7,685,000 representing a growth of $326,000, or 4.4% over the $7,359,000 realized during the third quarter last year. On a fully taxable equivalent basis (FTE), net interest income for the third quarter of 2007 and 2006 was $7,938,000 and $7,640,000, respectively.

The table that follows states rates on a fully taxable equivalent basis (FTE):

	Three Months Ended					
	September 2007			September 2006		
(Dollars in thousands)	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate
Interest Earning Assets:						
Federal funds sold & interest bearing bank balances	$ 11,853	$ 155	5.19%	$ 25,285	$ 341	5.35%
Investment securities	87,631	1,188	5.45%	94,512	1,209	5.15%
Total loans	669,026	12,566	7.39%	590,653	11,005	7.34%
Total interest-earning assets	768,510	13,909	7.13%	710,450	12,555	6.97%
Interest Bearing Liabilities:						
Interest bearing demand deposits	$ 214,179	$ 1,215	2.25%	$ 166,954	$ 521	1.24%
Savings deposits	71,394	353	1.96%	91,972	523	2.26%
Time deposits	286,354	3,356	4.65%	277,985	3,039	4.34%
Short term borrowings	52,787	642	4.83%	45,092	558	4.91%
Long term borrowings	32,047	405	4.95%	21,762	274	4.94%
Total interest bearing liabilities	656,761	5,971	3.61%	603,765	4,915	3.23%
Net interest income / net interest spread		$ 7,938	3.52%		$ 7,640	3.74%
Net interest margin			4.05%			4.23%

Interest Income FTE

FTE interest income totaled $13,909,000 for the third quarter of 2007 versus $12,555,000 for the same period last year, a difference of $1,354,000, or 10.8%. The earning asset yield rose from 6.97% during the third quarter 2006 to 7.13% for the third quarter 2007. Continued strong loan demand, particularly commercial loans, fueled the increase in yield. Commercial loans outstanding grew by $63.2 million while consumer loans increased by $11.5 million.

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Interest Expense

Interest expense increased $1,056,000 or 21.5%, to $5,971,000. Interest bearing liabilities increased to $656.8 million from $603.8 million, or 8.8%. The rate paid on interest bearing liabilities rose from 3.23% during third quarter 2006 to 3.61% for third quarter 2007. This increase in cost of funds occurred despite the 50 basis point drop in key rates during September 2007. The impact of the rate drop should be noticed more in the fourth quarter 2007. Savings account balances have declined $20.6 million from the third quarter 2006 as interest bearing demand deposits have increased in volume by $47.2 million, primarily in money market accounts. The introduction of a reward checking account product in the second quarter has helped increase checking account deposits by $9.3 million over last year. Time deposit accounts have increased by $8.4 million versus the third quarter of 2006.

Net Interest Income

Net interest income has continued to increase each quarter primarily due to volume factors as growth has remained strong, particularly in the commercial loan area. Although the Company has had steady growth in net interest income, the net interest spread has decreased from 3.74% to 3.52% and the net interest margin has decreased from 4.23% during third quarter 2006 to 4.05% during third quarter 2007. The cost of funds has continued to increase due to disintermediation to higher paying products. The net interest margin has strengthened slightly as we have moved through 2007. The third quarter s 4.05% margin represented the highest quarterly margin during the year. Our balance sheet was adequately balanced to enable us to offset the effect of September s 50 basis point rate drop.

Noninterest Income

Total noninterest income, excluding securities gains, increased $746,000, or 26.7%, from $2,789,000 to $3,535,000. Net securities losses in the third quarter 2006 were $12,000 compared to the $27,000 of net gains taken in the third quarter of 2007. Service charges on deposits increased 18.1% or $242,000. Overdraft protection fees rose $138,000 and revenue from debit card utilization grew $96,000 promoted by our reward checking product. Other service charges increased by $147,000, or 35.2%, including secondary market mortgage fees of $77,000 and ATM fees of $14,000. Asset management fees contributed an additional $115,000 and brokerage fees gained by $129,000, or 39.9%. Other income increased by $113,000 due in part to the addition of life insurance income of $60,000.

Noninterest Expense

Other expenses rose from $5,865,000 during the third quarter 2006 to $6,220,000 during the third quarter of 2007, an increase of $355,000, or 6.1%. The increase in salaries and benefits of 6.9%, or $243,000 was the major contributor to noninterest expense. The increase in the cost of employee benefits has continued to rise. Health insurance has increased 19.6% or $56,000 and profit sharing expense has grown by $64,000. Employee stock option grants accounted for $143,000 of third quarter expense.

Occupancy and equipment expense rose only 4.4%, or $38,000. The reduction of costs in leasing and maintenance expense and the fact that no additional branch offices have been opened during 2007 kept costs down in this area. Data processing costs were relatively steady. Other operating expense increased by 7.3%, or $84,000. Deposit charge off expense grew $62,000 and expanded usage of debit cards caused an increase of $58,000 in processing expense. Offsetting some of the increases in expense were many reductions in costs this quarter.

The Corporation s overhead efficiency ratio improved to 53.65% for the current quarter versus the third quarter 2006 ratio of 55.44%. The improvement in this ratio helps to point out the efficiencies gained with the combination of the two bank charters during the second quarter of 2007.

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Nine months ended September 30, 2007 compared to Nine months ended September 30, 2006

Net interest income for the first nine months of 2007 was $22,205,000 representing a growth of $2,107,000, or 10.5% over the $20,098,000 realized during the same period last year. On a fully taxable equivalent basis (FTE), net interest income for the first nine months of 2007 and 2006 was $22,952,000 and $20,841,000, respectively.

The table that follows states rates on a fully taxable equivalent basis (FTE):

	Nine Months Ended					
	September 2007			September 2006		
(Dollars in thousands)	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate
Interest Earning Assets:						
Federal funds sold & interest bearing bank balances	$ 14,005	$ 556	5.31%	$ 21,529	$ 803	4.99%
Investment securities	88,261	3,504	5.33%	84,611	3,202	5.07%
Total loans	647,706	35,922	7.34%	531,577	28,937	7.21%
Total interest-earning assets	749,972	39,982	7.06%	637,717	32,942	6.85%
Interest Bearing Liabilities:						
Interest bearing demand deposits	$ 196,139	$ 2,908	1.98%	$ 154,533	$ 1,247	1.08%
Savings deposits	76,261	1,159	2.03%	88,324	1,541	2.33%
Time deposits	289,123	10,025	4.64%	228,607	6,993	4.09%
Short term borrowings	47,521	1,722	4.78%	38,956	1,330	4.50%
Long term borrowings	33,306	1,216	4.82%	29,410	990	4.44%
Total interest bearing liabilities	642,350	17,030	3.54%	539,830	12,101	3.00%
Net interest income / net interest spread		$ 22,952	3.52%		$ 20,841	3.85%
Net interest margin			4.03%			4.32%

Interest Income FTE

Interest income totaled $39,982,000 for the first nine months of 2007 versus $32,942,000 for the same period last year, a growth of 21.4%. The Corporation s earning asset yield increased 21 basis points from the prior year s 6.85% to 7.06% for the first nine months of 2007. Earning asset volume grew 17.6% fueled by continued strong loan demand. About 8.4% of the growth in volume of interest earning assets in 2007 was due to the acquisition of First National in May 2006. The total loan portfolio increased by $116.1 million, or 21.8%, over the same period last year, about 14.9% of this is organic growth. The majority of the growth continues to be in the commercial loan portfolio which increased from $351.6 million to $431.4 million or 22.7%.

Interest Expense

Total interest expense increased $4,929,000 from $12,101,000 to $17,030,000 or 40.7% over the first nine months of 2006. Interest bearing demand deposits have increased over the first nine months of 2006 by $41.6 million. Non-interest demand deposits have increased by $6.3 million in the same period. Growth in money market deposit accounts of $44.6 million offset the decrease in savings products of $12.1 million. Time deposits balances have increased by $60.5 million, or 26.5%. Approximately 11.2% of the growth in time deposits was due to the acquisition of First National. Short term borrowings have increased in volume due to the popularity of our repurchase agreement product as a cash management tool.

Net Interest Income

While earning asset yields have increased by 21 basis points, the rate on interest bearing liabilities has increased by 54 basis points. The interest spread decreased from 3.85% to 3.52% and the interest margin, which factors in noninterest bearing funds, decreased from 4.32% during the first nine months of 2006 to 4.03% during the first nine months of 2007. Disintermediation caused, in part, by the inverted yield curve and an increasingly competitive market and market competition has been a factor in our net interest margin decline versus 2006, but spreads have widened slightly as we have advanced through 2007. The third quarter s 4.05% net interest margin represents our best quarter of 2007.

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Noninterest Income

Other income, excluding securities gains, increased $1,761,000, or 22.0%, from $8,018,000 to $9,779,000. Securities gains (losses) increased from $39,000 of net gains in 2006 to $58,000 in 2007. $45,000 of net gains were taken in the first quarter of 2007 from the sale of equity securities which were replaced, in part, by other equity securities with greater potential. Service charges on deposits increased 23.2% or $790,000. Overdraft protection revenue increased $549,000, while debit card fees added $167,000 and merchant account service charges added $73,000 on a year to date basis.

Other service charges increased by $169,000. ATM fees increased by $94,000 and loan fees generated an additional $135,000 versus the prior year. Income related to insurance affiliates decreased by $70,000 due in part to the sale of the investment in CBIA in the second quarter of 2007. The sale of this investment contributed $219,000 of nonrecurring gains.

Revenue from the asset management area maintained its growth trend during 2007, with trust revenue growing by $199,000 and brokerage income increasing by $215,000, or 22.0%, over the first nine months of 2006. Trust assets under management reached $414 million at September 30, 2007.

Noninterest Expense

Other expenses rose from $15,763,000 during the first nine months of 2006 to $18,314,000 during the same period of 2007, an increase of $2,551,000, or 16.2%. Salaries increased by $1,055,000. Benefit expense grew overall by $476,000. Employee insurance expense increased by $215,000, and employment tax expense increased by $125,000, due in part to the First National acquisition. Profit sharing expense grew by $155,000.

Occupancy and equipment expense rose $263,000, or 10.8%. The addition of the four Perry County offices, the Hagerstown office and an additional Mechanicsburg office during 2006 contributed to the increase. Depreciation expense increased $113,000 while maintenance and repair costs grew by $103,000. Data processing expense decreased $14,000 versus 2006 due to the combination of the two banks core processing systems.

Other operating expenses increased by $716,000, or 25.2%. Organic growth plus the First National acquisition created the increase in operating expense. Pennsylvania shares tax expense grew by $98,000, telephone expense rose by $104,000, printing and supplies expense increased $93,000 over last year and legal expense increased $84,000. Amortization expense increased $56,000 given the amortization of intangibles from the First National acquisition. Nonrecurring expense of $78,000 arose with the combination of the two bank subsidiaries into one bank charter in June 2007.

The overhead efficiency ratio increased to 55.35% for the first nine months of 2007 compared to the 53.77% last year. The addition of First National and the compressed net interest margin caused the efficiency ratio to rise but it is still quite favorable compared to peers.

The efficiency ratio has been improving each quarter during 2007 from 57.48% in March, to 55.13% in June to 53.65% for the current quarter 2007. This improvement in the efficiency ratio during 2007 is indicative of the economies of scale realized through the combination of the banks in June 2007. Orrstown is pleased to have held its efficiency ratio below 60% consistently, which is admirable for a banking company with less than $1 billion of assets.

INCOME TAX EXPENSE

Income tax expense increased $201,000, or 15.8%, during the third quarter of 2007 versus the third quarter of 2006. For the first nine months of 2007 the income tax expense rose $342,000 or 9.4% over the same period 2006. The marginal federal income tax bracket is 35% for 2007 and 2006.

Effective income tax rates were as follows:

	Three Months Ended		Nine Months Ended	
	September 2007	September 2006	September 2007	September 2006

Effective income tax rate	30.0%	29.7%	29.5%	29.6%

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PROVISION AND ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration factors such as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrowers ability to pay. Through this review and evaluation process, an amount deemed adequate to meet current growth and future loss expectations is charged to operations. The unallocated portion of the reserve ensures that any additional unforeseen losses that are not otherwise identifiable will be able to be absorbed. It is intended to provide for imprecise estimates in assessing projected losses, uncertainties in economic conditions and allocating pool reserves. Management deems the total of the allocated and unallocated portions of the allowance for loan losses to be adequate to absorb any losses at this time.

The provision for loan losses amounted to $90,000 and $36,000 for the third quarter of 2007 and 2006, respectively. These provisions compared to net charge-offs of $40,000 during the third quarter 2007 and $21,000 during the same period last year. The reserve to loan ratio for the Corporation was 0.82% at September 30, 2007 compared to 0.86% on September 30, 2006.

For the first nine months of 2007 the provision for loan losses was $240,000 compared to $108,000 taken in the first nine months of 2006. The year to date net charge-offs for 2007 were $117,000 compared to $64,000 of net charge-offs for the same period 2006. On May 1, 2006, an addition of $720,000 was established for the provision of the loans acquired with First National Bank of Newport.

The provision for loan losses and the other changes in the allowance for loan losses are shown below:

	Three Months Ended		Nine Months Ended	
(Dollars in Thousands)	**September 2007**	**September 2006**	**September 2007**	**September 2006**
Balance at beginning of period	$ 5,593	$ 5,177	$ 5,520	$ 4,428
Provision for loan losses	90	36	240	108
Recoveries	11	6	28	19
Loan charge-offs	(51)	(27)	(145)	(83)
Additions established for acquired credit risk	0	0	0	720
Balance at end of period	$ 5,643	$ 5,192	$ 5,643	$ 5,192

NONPERFORMING ASSETS / RISK ELEMENTS

Nonperforming assets at September 30, are as follows:

(Dollars in Thousands)	**2007**	**2006**
Loans on nonaccrual (cash) basis	$ 46	$ 161
Loans whose terms have been renegotiated	0	0
OREO	189	774
Total nonperforming loans and OREO	235	935
Loans past due 90 or more days and still accruing	4,804	594
Total nonperforming and other risk assets	$ 5,039	$ 1,529
Ratio of total risk assets to total loans and OREO	0.74%	0.25%
Ratio of total risk assets to total assets	0.58%	0.20%

Any loans classified for regulatory purposes as loss, doubtful, substandard or special mention that have not been disclosed under Item III of Industry Guide 3 do not represent or result from trends or uncertainties which management reasonably expects will materially impact future operating results, liquidity or capital resources.

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CAPITAL

Orrstown Financial Services, Inc. is a financial holding company and, as such, must maintain a well capitalized status in its bank subsidiary. Management foresees no problem in maintaining capital ratios well in excess of regulatory minimums. A comparison of Orrstown Financial Services, Inc. s capital ratios to regulatory minimum requirements at September 30, 2007 are as follows:

	Orrstown Financial Services, Inc.	Regulatory Minimum	Regulatory Well Capitalized Minimum
Leverage Ratio	8.71%	4%	5%
Risk Based Capital Ratios:			
Tier I Capital Ratio	10.73%	4%	6%
Total (Tier I & II) Capital Ratio (core capital plus allowance for loan losses)	11.59%	8%	10%

All growth experienced during 2007 has been supported by capital growth in the form of retained earnings. Equity represented 10.81% of assets at September 30, 2007 and 11.05% at December 31, 2006.

Management is not aware of any current recommendations by regulatory authorities which, if implemented, would have a material effect on the Corporation s liquidity, capital resources or operations.

LIQUIDITY

The primary function of asset/liability management is to assure adequate liquidity while minimizing interest rate risk. Liquidity management involves the ability to meet the cash flow requirements of customers who may be either depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. Sources of liquidity include investment securities, loan and lease income and payments, and increases in customer s deposit accounts. Additionally, Orrstown Bank is a Federal Home Loan Bank (FHLB) member, and standard credit arrangements available to FHLB members provide increased liquidity. Funds provided from financing activities were the primary source of liquidity for the first nine months of 2007. Additional liquidity was also provided by operating activities and proceeds from long-term borrowings.

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PART I FINANCIAL INFORMATION

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the exposure to interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market rate or price risks. For domestic banks, the majority of market risk is related to interest rate risk.

Interest rate sensitivity management requires the maintenance of an appropriate balance between interest sensitive assets and liabilities. Interest bearing assets and liabilities that are maturing or repricing should be adequately balanced to avoid fluctuating net interest margins and to enhance consistent growth of net interest income through periods of changing interest rates. The Corporation has consistently followed a strategy of pricing assets and liabilities according to prevailing market rates while largely matching maturities, within the guidelines of sound marketing and competitive practices. Rate sensitivity is measured by monthly gap analysis, quarterly rate shocks, and periodic simulation. The cumulative gap position at 12 months is slightly negative as of September 30, 2007. The cumulative gap was a negative $25,663,000 and the RSA/ RSL cumulative ratio was 0.93% which has increased from the 0.88% at December 31, 2006. The cumulative RSA/RSL at September 30, 2007 is 0.86% at three months and 0.84% at six months. However, the Corporation enjoys a closely balanced position that does not place it at undue risk under any interest rate scenarios. Many of the deposit dollars in transaction accounts are discretionarily priced so management maintains significant pricing flexibility.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures:

The Corporation s Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Corporation s disclosure controls and procedures (as such term is defined in Rules 13a-14(c) under the Securities Exchange Act of 1934, as amended) as of September 30, 2007. Based on such evaluation, such officers have concluded that, as of September 30, 2007, the Corporation s disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to the Corporation (including its consolidated subsidiary) required to be included in the Corporation s periodic filings under the Exchange Act.

(b) Changes in internal controls:

There have not been any significant changes in the Corporation s internal control over financial reporting or in other factors that could significantly affect such control during the third quarter of 2007.

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PART II OTHER INFORMATION

Item 1 Legal Proceedings

The nature of Orrstown Financial Services, Inc. s business generates a certain amount of litigation involving matters arising out of the ordinary course of business. In the opinion of management, there are no legal proceedings that might have a material effect on the results of operations, liquidity, or the financial position of Orrstown at this time.

Item 1A Risk Factors

There are a number of significant risks and uncertainties, including those specified below, that may adversely affect the Corporation s business, financial results or stock price. Additional risks that the Corporation currently does not know about or currently views as immaterial may also impair the Corporation s business or adversely impact its financial results or stock price.

Factors that might cause such differences include, but are not limited to the following: (1) competitive pressures among financial institutions increasing significantly in the markets where the Corporation operates; (2) general business and economic conditions, either nationally or locally being less favorable than expected; (3) changes in the domestic interest rate environment could reduce the Corporation s net interest income; (4) legislation or regulatory changes which adversely affect the ability of the Corporation to conduct its current or future operations; (5) acts or threats of terrorism and political or military actions taken by the United States or other governments and natural disasters globally or nationally could adversely affect general economic or industry conditions; (6) operational losses related to or resulting from: the risk of fraud by employees or persons outside of the Corporation, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system, business continuation and disaster recovery, as well as security risks associated with hacking and identity theft ; (7) negative publicity could damage the Corporation s reputation and adversely impact its business and/or stock trades and prices; (8) acquisitions may not produce revenue enhancements or cost savings at levels or within timeframes originally anticipated and may result in unforeseen integration difficulties; (9) the Corporation relies on other companies to provide key components of business infrastructure in the form of third party vendors. Third party vendors could adversely affect the ability of the Corporation to perform its normal course of business or deliver products and services to its customers; (10) and other risk factors that may occur in current or future operations.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

The table below summarizes the Company s repurchase of common equity securities during the quarter ended September 30, 2007:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that may Yet be Purchased Under the Plans or Programs (1)
7/1/07 through 7/31/07	500	$ 30.62	N/A	117,751
8/1/07 through 8/31/07	2,418	30.91	N/A	115,333
9/1/07 through 9/30/07	2,741	31.16	N/A	112,592
Total	5,659	$ 31.00		

(1) On April 27, 2006, Orrstown Financial Services, Inc. announced a Stock Repurchase Plan approving the purchase of up to 150,000 shares as conditions allow. The plan may be suspended at any time without prior notice and has no prescribed time limit in which to fill the authorized repurchase amount. As of September 30, 2007, 37,408 shares have been purchased under the program. Orrstown did not sell any unregistered securities.

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Item 3 Defaults upon Senior Securities

Not applicable

Item 4 Submission of Matters to a Vote of Security Holders

None

Item 5 Other Information

None

Item 6 Exhibits

3.1 Articles of Incorporation. Incorporated by reference to Exhibit 3.1 of the Registrant s Registration Statement on Form S-4, Registration No. 333-131176.

3.2 By-laws. Incorporated by reference to Exhibit 3.2 of the Registrant s Registration Statement on Form S-4, Registration No. 33-18888.

4 Instruments defining the rights of security holders including indentures. The rights of the holders of Registrant s common stock are contained in:

(i) Articles of Incorporation of Orrstown Financial Services, Inc., incorporated by reference to Exhibit 3.1 of the Registrant s Registration Statement on Form S-4, Registration No.333-131176.

(ii) By-laws of Orrstown Financial Services, Inc., incorporated by reference to Exhibit 3.2 to the Registrant s Registration Statement on Form S-4, Registration No. 33-18888.

31.1 Rule 13a - 14(a)/15d-14(a) Certification (Chief Executive Officer) filed herewith

31.2 Rule 13a - 14(a)/15d-14(a) Certifications (Chief Financial Officer) filed herewith

32.1 Section 1350 Certifications (Chief Executive Officer) filed herewith

32.2 Section 1350 Certifications (Chief Financial Officer) filed herewith

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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.

/s/ Kenneth R. Shoemaker
(Kenneth R. Shoemaker, President & CEO)
(Duly Authorized Officer)

/s/ Bradley S. Everly
(Bradley S. Everly, Senior Vice President & CFO)
(Chief Financial Officer)

/s/ Robert B. Russell
(Robert B. Russell, Controller)
(Chief Accounting Officer)

Date: November 5, 2007

ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARIES

EXHIBIT INDEX

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