

JUNIATA VALLEY FINANCIAL CORP

Form 10-Q

November 09, 2006

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

(Mark One)

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

For the quarterly period ended September 30, 2006

**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 000-13232**

**Juniata Valley Financial Corp.**

(Exact name of registrant as specified in its charter)

Pennsylvania

23-2235254

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

Bridge and Main Streets, Mifflintown, Pennsylvania

17059

(Address of principal executive offices)

(Zip Code)

(717) 436-8211

(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  No

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  Accelerated filer  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

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

| Class                           | Outstanding as of November 4, 2006 |
|---------------------------------|------------------------------------|
| Common Stock (\$1.00 par value) | 4,457,184 shares                   |

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**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Juniata Valley Financial Corp. and Subsidiary**

## Consolidated Statements of Financial Condition

(Amounts in thousands, except share data)

|  | <b>September<br/>30,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> |
|--|-----------------------------------|----------------------------------|
|  | Unaudited                         | Audited                          |
| <b>ASSETS</b>  |                                   |                                  |
| Cash and due from banks  | \$ 9,683                          | \$ 16,373                        |
| Interest bearing deposits with banks   | 110                               | 66                               |
| Cash and cash equivalents  | 9,793                             | 16,439                           |
| Interest bearing time deposits with banks                                    | 5,660                             | 5,660                            |
| Securities available for sale  | 61,415                            | 66,699                           |
| Securities held to maturity, fair value of \$8,564 and \$3,436, respectively | 8,599                             | 3,493                            |
| Restricted investment in Federal Home Loan Bank (FHLB) stock                 | 1,467                             | 1,356                            |
| Investment in unconsolidated subsidiary                                      | 2,825                             |                                  |
| Total loans, net of unearned interest  | 308,418                           | 298,063                          |
| Less: Allowance for loan losses  | (2,793)                           | (2,763)                          |
| Total loans, net of allowance for loan losses                                | 305,625                           | 295,300                          |
| Premises and equipment, net  | 6,345                             | 6,211                            |
| Bank owned life insurance  | 10,919                            | 10,647                           |
| Accrued interest receivable and other assets                                 | 5,882                             | 4,997                            |
| Core deposit intangible  | 445                               |                                  |
| Goodwill   | 2,039                             |                                  |
| <b>Total assets</b>  | <b>\$ 421,014</b>                 | <b>\$ 410,802</b>                |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                                   |                                   |                                  |
| <b>Liabilities:</b>  |                                   |                                  |
| Deposits:  |                                   |                                  |
| Non-interest bearing   | \$ 43,223                         | \$ 46,041                        |
| Interest bearing   | 315,544                           | 297,426                          |
| Total deposits   | 358,767                           | 343,467                          |
| Securities sold under agreements to repurchase                               | 5,942                             | 4,201                            |
| Short-term borrowings  | 2,500                             | 5,600                            |
| Long-term debt   |                                   | 5,000                            |
| Other interest bearing liabilities   | 895                               | 819                              |

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|  |                   |                   |
|--|-------------------|-------------------|
| Accrued interest payable and other liabilities   | 5,064             | 4,596             |
| <b>Total liabilities</b>                         | <b>373,168</b>    | <b>363,683</b>    |
| <b>Stockholders Equity:</b>                      |                   |                   |
| Preferred stock, no par value:                   |                   |                   |
| Authorized - 500,000 shares, none issued         |                   |                   |
| Common stock, par value \$1.00 per share:        |                   |                   |
| Authorized - 20,000,000 shares;                  |                   |                   |
| Issued - 4,745,826 shares                        |                   |                   |
| Outstanding -                                    |                   |                   |
| 4,457,184 shares at September 30, 2006;          |                   |                   |
| 4,503,392 shares at December 31, 2005            | 4,746             | 4,746             |
| Surplus  | 18,253            | 18,177            |
| Retained earnings                                | 30,942            | 29,486            |
| Accumulated other comprehensive loss             | (428)             | (694)             |
| Cost of common stock in Treasury:                |                   |                   |
| 288,642 shares at September 30, 2006;            |                   |                   |
| 242,434 shares at December 31, 2005              | (5,667)           | (4,596)           |
| <b>Total stockholders equity</b>                 | <b>47,846</b>     | <b>47,119</b>     |
| <b>Total liabilities and stockholders equity</b> | <b>\$ 421,014</b> | <b>\$ 410,802</b> |

See accompanying notes to consolidated financial statements.

**Juniata Valley Financial Corp. and Subsidiary**  
Consolidated Statements of Income  
(Unaudited)  
(Dollar amounts in thousands, except share data)

|  | <b>Three Months Ended</b> |              | <b>Nine Months Ended</b> |               |
|--|---------------------------|--------------|--------------------------|---------------|
|  | <b>September 30,</b>      |              | <b>September 30,</b>     |               |
|  | <b>2006</b>               | <b>2005</b>  | <b>2006</b>              | <b>2005</b>   |
| <b>Interest income:</b>                                    |                           |              |                          |               |
| Loans, including fees                                      | \$ 5,501                  | \$ 4,989     | \$ 16,082                | \$ 14,710     |
| Taxable securities   | 502                       | 442          | 1,488                    | 1,403         |
| Tax-exempt securities                                      | 158                       | 163          | 481                      | 498           |
| Other interest income                                      | 71                        | 138          | 191                      | 294           |
| <b>Total interest income</b>                               | <b>6,232</b>              | <b>5,732</b> | <b>18,242</b>            | <b>16,905</b> |
| <b>Interest expense:</b>                                   |                           |              |                          |               |
| Deposits   | 2,435                     | 2,011        | 6,885                    | 5,558         |
| Securities sold under agreements to repurchase             | 68                        | 51           | 171                      | 101           |
| Short-term borrowings                                      | 78                        | 1            | 258                      | 8             |
| Long-term debt   | 16                        | 36           | 88                       | 108           |
| Other interest bearing liabilities                         | 9                         | 5            | 20                       | 15            |
| <b>Total interest expense</b>                              | <b>2,606</b>              | <b>2,104</b> | <b>7,422</b>             | <b>5,790</b>  |
| <b>Net interest income</b>                                 | <b>3,626</b>              | <b>3,628</b> | <b>10,820</b>            | <b>11,115</b> |
| Provision for loan losses                                  | 29                        |              | 89                       | 28            |
| <b>Net interest income after provision for loan losses</b> | <b>3,597</b>              | <b>3,628</b> | <b>10,731</b>            | <b>11,087</b> |
| <b>Noninterest income:</b>                                 |                           |              |                          |               |
| Trust fees   | 99                        | 86           | 323                      | 276           |
| Customer service fees                                      | 395                       | 353          | 1,118                    | 1,036         |
| Earnings on bank-owned life insurance                      | 134                       | 95           | 318                      | 273           |
| Commissions from sales of annuities and mutual funds       | 143                       | 105          | 406                      | 323           |
| Gain on sale of loans and other assets                     | 28                        | 9            | 51                       | 15            |
| Gain on sale of securities                                 |                           | 52           | 67                       | 151           |
| Income from unconsolidated subsidiary                      | 20                        |              | 20                       |               |
| Other noninterest income                                   | 148                       | 138          | 435                      | 375           |
| <b>Total noninterest income</b>                            | <b>967</b>                | <b>838</b>   | <b>2,738</b>             | <b>2,449</b>  |
| <b>Noninterest expense:</b>                                |                           |              |                          |               |
| Salaries and wages   | 1,185                     | 1,079        | 3,417                    | 3,255         |
| Employee severance expense                                 |                           |              |                          | 284           |
| Employee benefits  | 375                       | 335          | 1,113                    | 1,094         |
| Occupancy  | 195                       | 214          | 600                      | 631           |

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|  |                 |                 |                 |                 |
|--|-----------------|-----------------|-----------------|-----------------|
| Equipment  | 148             | 148             | 455             | 438             |
| Data processing expense                                      | 309             | 307             | 869             | 917             |
| Director compensation  | 120             | 114             | 369             | 363             |
| Professional fees  | 97              | 305             | 283             | 623             |
| Taxes, other than income                                     | 129             | 130             | 375             | 389             |
| Other noninterest expense                                    | 281             | 327             | 869             | 838             |
| <b>Total noninterest expense</b>                             | <b>2,839</b>    | <b>2,959</b>    | <b>8,350</b>    | <b>8,832</b>    |
| <b>Income before income taxes</b>                            | <b>1,725</b>    | <b>1,507</b>    | <b>5,119</b>    | <b>4,704</b>    |
| Provision for income taxes                                   | 494             | 416             | 1,464           | 1,307           |
| <b>Net income</b>  | <b>\$ 1,231</b> | <b>\$ 1,091</b> | <b>\$ 3,655</b> | <b>\$ 3,397</b> |
| <b>Earnings per share</b>                                    |                 |                 |                 |                 |
| Basic  | \$ 0.27         | \$ 0.24         | \$ 0.81         | \$ 0.74         |
| Diluted  | \$ 0.27         | \$ 0.24         | \$ 0.81         | \$ 0.74         |
| Cash dividends declared per share                            | \$ 0.17         | \$ 0.00         | \$ 0.49         | \$ 0.80         |
| Weighted average shares outstanding                          | 4,485,365       | 4,568,060       | 4,488,992       | 4,562,132       |
| Weighted average shares and share equivalents outstanding    | 4,497,637       | 4,586,328       | 4,503,269       | 4,579,816       |
| See accompanying notes to consolidated financial statements. |                 |                 |                 |                 |

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**Juniata Valley Financial Corp. and Subsidiary**  
Consolidated Statements of Changes in Stockholders' Equity  
(Unaudited)  
(Amounts in thousands, except share data)  
**Nine Months Ended September 30, 2006**

|  | Number<br>of<br>Shares<br><br>Outstanding | Common<br>Stock | Surplus   | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Treasury<br>Stock | Total<br>Stockholders<br>Equity |
|--|---|-----------------|-----------|----------------------|---|-------------------|---------------------------------|
| <b>Balance at<br/>December 31, 2005</b>  | 4,503,392                                 | \$ 4,746        | \$ 18,177 | \$ 29,486            | \$ (694)  | \$ (4,596)        | \$ 47,119                       |
| Comprehensive<br>income:   |   |                 |           |                      |   |                   |                                 |
| Net income   |   |                 |           | 3,655                |   |                   | 3,655                           |
| Change in unrealized<br>losses on securities<br>available for sale, net<br>of reclassifica-<br>tion<br>adjustment and tax<br>effects |   |                 |           |                      | 266   |                   | 266                             |
| Total comprehensive<br>income  |   |                 |           |                      |   |                   | 3,921                           |
| Cash dividends at<br>\$0.49 per share  |   |                 |           | (2,199)              |   |                   | (2,199)                         |
| Stock-based<br>compensation<br>activity  |   |                 | 28        |                      |   |                   | 28                              |
| Purchase of treasury<br>stock, at cost   | (58,082)                                  |                 |           |                      |   | (1,302)           | (1,302)                         |
| Treasury stock issued<br>for dividend<br>reinvestment plan<br>and employee stock<br>purchase plan                                    | 11,874                                    |                 | 48        |                      |   | 231               | 279                             |
| <b>Balance at<br/>September 30, 2006</b>   | 4,457,184                                 | \$ 4,746        | \$ 18,253 | \$ 30,942            | \$ (428)  | \$ (5,667)        | \$ 47,846                       |

**Nine Months Ended September 30, 2005**

|  | Number<br>of<br>Shares<br><br>Outstanding | Common<br>Stock | Surplus | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Treasury<br>Stock | Total<br>Stockholders<br>Equity |
|--|---|-----------------|---------|----------------------|---|-------------------|---------------------------------|
|--|---|-----------------|---------|----------------------|---|-------------------|---------------------------------|



|  |           |          |           |           |          |            |           |
|--|-----------|----------|-----------|-----------|----------|------------|-----------|
| <b>Balance at<br/>December 31, 2004</b>  | 2,280,629 | \$ 2,373 | \$ 20,386 | \$ 29,966 | \$ 414   | \$ (2,986) | \$ 50,153 |
| Comprehensive<br>income:   |           |          |           |           |          |            |           |
| Net income   |           |          |           | 3,397     |          |            | 3,397     |
| Minimum pension<br>liability adjustment,<br>net of tax effects   |           |          |           |           | (631)    |            | (631)     |
| Change in unrealized<br>losses on securities<br>available for sale, net<br>of reclassifica-<br>tion<br>adjustment and tax<br>effects |           |          |           |           | (694)    |            | (694)     |
| Total comprehensive<br>income  |           |          |           |           |          |            | 2,072     |
| Cash dividends at<br>\$.80 per share   |           |          |           | (3,644)   |          |            | (3,644)   |
| Treasury stock issued<br>for dividend<br>reinvestment plan<br>and employee stock<br>purchase plan                                    | 21,086    |          | 97        |           |          | 348        | 445       |
| Purchase of treasury<br>stock, at cost   | (32,800)  |          |           |           |          | (763)      | (763)     |
| Stock issued<br>pursuant to 2 for 1<br>stock split effective<br>October 31, 2005   | 2,280,629 | 2,373    | (2,373)   |           |          |            |           |
| <b>Balance at<br/>September 30, 2005</b>   | 4,549,544 | \$ 4,746 | \$ 18,110 | \$ 29,719 | \$ (911) | \$ (3,401) | \$ 48,263 |

See accompanying notes to consolidated financial statements.

**Juniata Valley Financial Corp. and Subsidiary**  
Consolidated Statements of Cash Flows  
(Unaudited)  
(Amounts in thousands)

|   | <b>Nine Months Ended September</b> |                 |
|---|------------------------------------|-----------------|
|   | <b>30,</b>                         |                 |
|   | <b>2006</b>                        | <b>2005</b>     |
| <b>Operating activities:</b>  |                                    |                 |
| Net income  | \$ 3,655                           | \$ 3,397        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |                 |
| Provision for loan losses   | 89                                 | 28              |
| Provision for depreciation  | 437                                | 453             |
| Net amortization of securities premiums   | 90                                 | 170             |
| Amortization of core deposit intangible   | 4                                  |                 |
| Gains on sales of securities  | (67)                               | (151)           |
| Gains on sales of loans and other assets  | (51)                               | (15)            |
| Earnings on investment in life insurance  | (318)                              | (273)           |
| Deferred income tax credit  | (67)                               |                 |
| Income from equity investment in unconsolidated subsidiary                        | (20)                               |                 |
| Stock-based compensation expense  | 28                                 |                 |
| Increase in accrued interest receivable and other assets                          | (909)                              | (288)           |
| Increase (decrease) in accrued interest payable and other liabilities             | 380                                | (98)            |
| <b>Net cash provided by operating activities</b>                                  | <b>3,251</b>                       | <b>3,223</b>    |
| <b>Investing activities:</b>  |                                    |                 |
| Purchases of:   |                                    |                 |
| Securities available for sale   | (7,196)                            | (8,084)         |
| Securities held to maturity   | (5,100)                            | (4,400)         |
| FHLB stock  | (765)                              |                 |
| Premises and equipment  | (432)                              | (103)           |
| Bank owned life insurance   | (103)                              |                 |
| Investment in unconsolidated subsidiary   | (2,805)                            |                 |
| Proceeds from:  |                                    |                 |
| Sales of available for sale securities  | 137                                | 336             |
| Maturities of and principal repayments on:  |                                    |                 |
| Securities available for sale   | 12,717                             | 11,098          |
| Securities held to maturity   |                                    | 1,000           |
| Redemption of FHLB stock  | 654                                | 240             |
| Bank owned life insurance   | 149                                |                 |
| Sale of other real estate owned   | 572                                |                 |
| Net decrease in interest-bearing time deposits                                    |                                    | 1,100           |
| Net cash received from branch acquisition   | 13,808                             |                 |
| Net increase in loans receivable  | (7,162)                            | (16,050)        |
| <b>Net cash provided by (used in) investing activities</b>                        | <b>4,474</b>                       | <b>(14,863)</b> |

**Financing activities:**

|   |         |         |
|---|---------|---------|
| Net (decrease) increase in deposits   | (4,790) | 13,443  |
| Net (decrease) increase in short-term borrowings and securities sold under agreements to repurchase | (1,359) | 2,693   |
| Repayment of long-term debt   | (5,000) |         |
| Cash dividends  | (2,199) | (3,644) |
| Purchase of treasury stock  | (1,302) | (763)   |
| Treasury stock issued for dividend reinvestment and employee stock purchase plan                    | 279     | 445     |

**Net cash (used in) provided by financing activities**

|  |          |           |
|--|----------|-----------|
|  | (14,371) | 12,174    |
| Net (decrease) increase in cash and cash equivalents | (6,646)  | 534       |
| Cash and cash equivalents at beginning of period     | 16,439   | 14,800    |
| Cash and cash equivalents at end of period           | \$ 9,793 | \$ 15,334 |

**Supplemental information:**

|                   |          |          |
|-------------------|----------|----------|
| Interest paid     | \$ 7,197 | \$ 5,675 |
| Income taxes paid | \$ 1,405 | \$ 1,651 |

**Supplemental schedule of noncash investing and financing activities:**

|  |        |    |
|--|--------|----|
| Transfer of loans to other real estate owned                 | \$ 630 | \$ |
| See accompanying notes to consolidated financial statements. |        |    |

**Juniata Valley Financial Corp. and Subsidiary**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE A Basis of Presentation and Accounting Policies**

The financial information includes the accounts of Juniata Valley Financial Corp. (the Corporation ) and its wholly owned subsidiary, The Juniata Valley Bank (the Bank ). All significant intercompany accounts and transactions have been eliminated.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for fair presentation have been included. Operating results for the three-month and nine-month periods ended September 30, 2006, are not necessarily indicative of the results for the year ended December 31, 2006. For further information, refer to the consolidated financial statements and footnotes thereto included in Juniata Valley Financial Corp. s annual report on Form 10-K for the year ended December 31, 2005.

Since December 31, 2005, the significant accounting policies described below became newly applicable to the Corporation:

**Business Combinations**

Business combinations are accounted for under the purchase method of accounting. Under the purchase method, assets and liabilities of the business acquired are recorded at their estimated fair values as of the date of the acquisition with any excess of the cost of the acquisition over the fair value of the net tangible and intangible assets acquired recorded as goodwill. Results of operations of the acquired business are included in the income statement from the date of acquisition.

**Goodwill and Other Intangible Assets**

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be separately distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. It is the Corporation s policy that goodwill be tested at least annually for impairment.

Intangible assets with finite lives include core deposits. Intangible assets are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Core deposit intangibles are amortized over a period of time that represents their expected life using a method of amortization that reflects the pattern of economic benefit.

All prior period share and per-share data presented has been restated to reflect the effect of a two for one stock split which was effective on October 31, 2005.

Certain prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no effect on net income or the statement of financial condition.

**NOTE B Recent Accounting Pronouncements**

In February 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( FAS ) No. 155, Accounting for Certain Hybrid Instruments, as an amendment of FASB Statements No. 133 and 140. FAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. This statement is effective for all financial instruments acquired or issued after the

beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of this standard is not expected to have a material effect on the Corporation's results of operations or financial position.

In March 2006, the FASB issued FAS No. 156, *Accounting for Servicing of Financial Assets*. This Statement, which is an amendment to FAS No. 140, will simplify the accounting for servicing assets and liabilities, such as those common with mortgage securitization activities. Specifically, FAS No. 156 addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like (offset) accounting. FAS No. 156 also clarifies when an obligation to service financial assets should be separately recognized as a servicing asset or a servicing liability, requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable, and permits an entity with a separately recognized servicing asset or servicing liability to choose either the amortization or fair value methods for subsequent measurement. The provisions of FAS No. 156 are effective as of the beginning of the first fiscal year that begins after September 15, 2006. The adoption of this standard is not expected to have a material effect on the Corporation's results of operations or financial position.

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. FIN 48 is an interpretation of FAS No. 109, *Accounting for Income Taxes*, and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN No. 48 requires expanded disclosure with respect to the uncertainty in income taxes and is effective for fiscal years beginning after December 15, 2006. The Corporation is currently evaluating the impact the adoption of the standard will have on the Corporation's results of operations.

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. FASB Statement No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. The Corporation is currently evaluating the impact the adoption of the standard will have on the Corporation's results of operations and financial position.

On September 29, 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date—the date at which the benefit obligation and plan assets are measured—is required to be the Corporation's fiscal year end. SFAS 158 is effective for publicly-held companies for fiscal years ending after December 15, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The Corporation is currently evaluating the impact the adoption of the standard will have on the Corporation's results of operations and financial position.

On September 13, 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, companies might evaluate the materiality of financial-statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company's balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach.

In June 2006, the Emerging Issues Task Force (EITF) released Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (EITF 06-4). This EITF consensus opinion was ratified by the FASB on September 20, 2006. EITF 06-4 requires employers who have entered into a split-dollar life insurance arrangement with an employee that extends to post-retirement



periods, to recognize a liability and related compensation costs in accordance with SFAS No. 106, Accounting for Post Retirement Benefit Obligations or Accounting Principles Board Opinion No. 12, Omnibus Opinion. The effective date of EITF No. 06-4 is for fiscal years beginning after December 15, 2006, and the opinion may be adopted through either a cumulative effect adjustment to retained earnings at the beginning of the year of adoption, or through retrospective application to prior periods. The Corporation has split-dollar life insurance arrangements and is currently evaluating the impact the adoption of the standard will have on the Corporation's results of operations and financial position.

NOTE C Comprehensive Income

U.S. generally accepted accounting principles require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income (loss).

The components of comprehensive income and related tax effects are as follows (in thousands):

|   | Three Months Ended September 30,<br>2006 |                                   |                      | Three Months Ended September 30,<br>2005 |                                   |                      |
|---|--|-----------------------------------|----------------------|--|-----------------------------------|----------------------|
|   | Before<br>Tax<br>Amount                  | Tax<br>Expense<br>or<br>(Benefit) | Net-of-Tax<br>Amount | Before<br>Tax<br>Amount                  | Tax<br>Expense<br>or<br>(Benefit) | Net-of-Tax<br>Amount |
| Net income  | \$ 1,725                                 | \$ 494                            | \$ 1,231             | \$ 1,507                                 | \$ 416                            | \$ 1,091             |
| Other comprehensive<br>income (loss):                                   |  |                                   |                      |  |                                   |                      |
| Unrealized gains<br>(losses) on available for<br>sale securities :      |  |                                   |                      |  |                                   |                      |
| Unrealized gains<br>(losses) arising during the<br>period               | 527                                      | 179                               | 348                  | (339)                                    | (115)                             | (224)                |
| Less reclassification<br>adjustment for gains<br>included in net income |  |                                   |                      | (52)                                     | (18)                              | (34)                 |
| Other comprehensive<br>income (loss)                                    | 527                                      | 179                               | 348                  | (391)                                    | (133)                             | (258)                |
| Total comprehensive<br>income   | \$ 2,252                                 | \$ 673                            | \$ 1,579             | \$ 1,116                                 | \$ 283                            | \$ 833               |

|                                       | Nine Months Ended September 30,<br>2006 |                                   |                      | Nine Months Ended September 30, 2005 |                                   |                      |
|---------------------------------------|---|-----------------------------------|----------------------|--------------------------------------|-----------------------------------|----------------------|
|                                       | Before<br>Tax<br>Amount                 | Tax<br>Expense<br>or<br>(Benefit) | Net-of-Tax<br>Amount | Before<br>Tax<br>Amount              | Tax<br>Expense<br>or<br>(Benefit) | Net-of-Tax<br>Amount |
| Net income                            | \$ 5,119                                | \$ 1,464                          | \$ 3,655             | \$ 4,704                             | \$ 1,307                          | \$ 3,397             |
| Other comprehensive<br>income (loss): |   |                                   |                      |                                      |                                   |                      |

|   |          |          |          |          |        |          |
|---|----------|----------|----------|----------|--------|----------|
| Unrealized gains<br>(losses) on available for<br>sale securities :      |          |          |          |          |        |          |
| Unrealized gains<br>(losses) arising during the<br>period               | 470      | 160      | 310      | (900)    | (306)  | (594)    |
| Less reclassification<br>adjustment for gains<br>included in net income | (67)     | (23)     | (44)     | (151)    | (51)   | (100)    |
| Minimum pension<br>liability  |          |          |          | (956)    | (325)  | (631)    |
| Other comprehensive<br>income (loss)                                    | 403      | 137      | 266      | (2,007)  | (682)  | (1,325)  |
| Total comprehensive<br>income   | \$ 5,522 | \$ 1,601 | \$ 3,921 | \$ 2,697 | \$ 625 | \$ 2,072 |

## NOTE D Stock Option Plan

At September 30, 2006, the Corporation had a stock-based employee compensation plan. Prior to January 1, 2006, the Corporation accounted for this plan under the recognition and measurement provisions of APB Opinion No. 25,

Accounting for Stock Issued to Employees , and related Interpretations, as permitted by FASB Statement No. 123,

Accounting for Stock-Based Compensation . No stock-based employee compensation cost was recognized in the Consolidated Statements of Income for the periods reported prior to January 1, 2006, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Corporation adopted the fair value recognition provisions of FASB Statement No. 123(R),

Share-Based Payment , using the modified-prospective-transition method. Under that transition method,



compensation cost recognized in the first three quarters of 2006 include: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006 (if any), based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). No options were granted during the first nine months of 2006. Results for prior periods have not been restated.

As a result of adopting Statement 123(R) on January 1, 2006, the Corporation's income before taxes and net income for the quarter and year-to-date periods ended September 30, 2006 are \$9,000 and \$28,000, respectively, lower than if it had continued to account for share-based compensation under Opinion 25. Basic and diluted earnings per share for the quarter and nine month periods ended September 30, 2006 would have been \$0.28 and \$0.82 if the Corporation had not adopted Statement 123(R), an increase of \$0.01 for both basic and diluted earnings per share.

Prior to the adoption of Statement 123(R), the Corporation presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Consolidated Statements of Cash Flows. Statement 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for the options (excess tax benefits) to be classified as financing cash flows. There were no such tax benefits year-to-date through September 30, 2006.

The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of Statement 123 to options granted under the Corporation's stock option plan in prior periods presented. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing formula and amortized to expense over the options' vesting periods.

|   | <b>Three<br/>Months<br/>Ended<br/>September 30, 2005</b> | <b>Nine<br/>Months<br/>Ended<br/>September 30, 2005</b> |
|---|--|---|
| <i>(Dollar amounts in thousands, except share data)</i>   |  |   |
| Net income, as reported   | \$ 1,091   | \$ 3,397  |
| Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (5)  | (15)  |
| Pro forma net income  | \$ 1,086   | \$ 3,382  |
| Basic net income per share, as reported   | \$ 0.24  | \$ 0.74   |
| Pro forma basic net income per share  | \$ 0.24  | \$ 0.73   |
| Diluted net income per share, as reported   | \$ 0.24  | \$ 0.74   |
| Pro forma diluted net income per share  | \$ 0.24  | \$ 0.73   |

These computations were derived using the Black-Scholes option-pricing model with the following weighted average assumptions used for options granted in 2005. No options have been granted in the first three quarters of 2006:

Options Granted in 2005

|                          |                 |
|--------------------------|-----------------|
| Expected life of options | 2005<br>7 years |
| Risk-free interest rate  | 4.40%           |
| Expected volatility      | 21.13%          |
| Expected dividend yield  | 3.20%           |

## NOTE E Earnings Per Share

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

(Amounts, except earnings per share, in thousands)

|   | <b>Three Months<br/>Ended<br/>September 30,<br/>2006</b> | <b>Three Months<br/>Ended<br/>September 30,<br/>2005</b> |
|---|--|--|
| Net income  | \$ 1,231   | \$ 1,091   |
| Weighted-average common shares outstanding              | 4,485  | 4,568  |
| <b>Basic earnings per share</b>                         | <b>\$ 0.27</b>   | <b>\$ 0.24</b>   |
| Weighted-average common shares outstanding              | 4,485  | 4,568  |
| Common stock equivalents due to effect of stock options | 12   | 18   |
| Total weighted-average common shares and equivalents    | 4,497  | 4,586  |
| <b>Diluted earnings per share</b>                       | <b>\$ 0.27</b>   | <b>\$ 0.24</b>   |
|   | <b>Nine Months<br/>Ended<br/>September 30,<br/>2006</b>  | <b>Nine Months<br/>Ended<br/>September 30,<br/>2005</b>  |
| Net income  | \$ 3,655   | \$ 3,397   |
| Weighted-average common shares outstanding              | 4,489  | 4,562  |
| <b>Basic earnings per share</b>                         | <b>\$ 0.81</b>   | <b>\$ 0.74</b>   |
| Weighted-average common shares outstanding              | 4,489  | 4,562  |
| Common stock equivalents due to effect of stock options | 14   | 18   |
| Total weighted-average common shares and equivalents    | 4,503  | 4,580  |
| <b>Diluted earnings per share</b>                       | <b>\$ 0.81</b>   | <b>\$ 0.74</b>   |

NOTE F Commitments, Contingent Liabilities and Guarantees

In the ordinary course of business, the Corporation makes commitments to extend credit to its customers through letters of credit, loan commitments and lines of credit. At September 30, 2006, the Bank had \$45,455,000 outstanding in loan commitments and other unused lines of credit extended to its customers as compared to \$50,456,000 at December 31, 2005.

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its letters of credit. Letters of credit written are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit, have expiration dates within one year of issuance. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation, generally, holds collateral and/or personal guarantees supporting these commitments. The Corporation had \$867,000 and \$755,000 of letters of credit commitments as of September 30, 2006 and December 31, 2005, respectively. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of September 30, 2006, for guarantees under letters of credit issued is not material.

**NOTE G Defined Benefit Retirement Plan**

The Corporation has a defined benefit retirement plan covering substantially all of its employees. The benefits are based on years of service and the employees' compensation. The Corporation's funding policy is to contribute annually the maximum amount that can be deducted for federal income taxes purposes. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The Corporation expects to contribute \$300,000 to the defined benefit plan in 2006.

Pension expense included the following components for the three and nine month periods ended September 30, 2006 and 2005:

*(Dollar amounts in thousands)*

|  | <b>Three Months<br/>Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2006</b>                                     | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| <b>Components of net periodic pension cost</b> |   |             |  |             |
| Service cost                                   | \$ 74   | \$ 74       | \$ 222                                     | \$ 214      |
| Interest cost                                  | 91  | 87          | 275  | 260         |
| Expected return on plan assets                 | (90)  | (85)        | (270)                                      | (251)       |
| Additional recognized amounts                  | 18  | 26          | 54   | 63          |
| <br>   |   |             |  |             |
| Net periodic pension cost                      | \$ 93   | \$ 102      | \$ 281                                     | \$ 286      |

**NOTE H Acquisition**

On September 8, 2006, the Corporation completed its acquisition of a branch office in Richfield, PA. The acquisition included real estate, deposits and loans. The assets and liabilities of the acquired business were recorded on the balance sheet at their estimated fair values as of September 8, 2006, and their results of operations have been included in the consolidated statement of income since such date.

Included in the purchase price of the branch was goodwill and core deposit intangible of \$2,039,000 and \$449,000, respectively. The core deposit intangible will be amortized over a ten-year period on a straight line basis. The goodwill will not be amortized, but will be measured annually for impairment.

The following table summarizes the estimated fair value (in thousands) of the net liabilities assumed:

|                         |        |
|-------------------------|--------|
| Assets:                 |        |
| Cash                    | \$ 261 |
| Premises and equipment  | 139    |
| Loans                   | 3,810  |
| Core deposit intangible | 449    |
| Goodwill                | 2,039  |
| Other assets            | 9      |
| <br>                    |        |
| Total assets            | 6,707  |
| <br>                    |        |
| Liabilities:            |        |
| Deposits                | 20,090 |
| Other liabilities       | 164    |
| <br>                    |        |
| Total liabilities       | 20,254 |

Net liabilities assumed

\$ 13,547

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The estimated fair values of the assets and liabilities, including identifiable intangible assets, are preliminary and subject to refinement. Any subsequent adjustments to the fair values of assets and liabilities acquired, identifiable intangible assets or other purchase accounting adjustments will result in adjustments to goodwill within the first 12 months following the date of acquisition.

NOTE I Investment in Unconsolidated Subsidiary

On September 1, 2006, the Corporation invested in The First National Bank of Liverpool (FNBL), Liverpool, PA, by purchasing 39.16% of its outstanding common stock. This investment is accounted for under the equity method of accounting, as defined in Accounting Principles Board Opinion No. 18. The investment is being carried at \$2,825,000 as of September 30, 2006, of which \$1,776,000 represents the underlying equity in net assets of FNBL. The difference between the investment carrying amount and the amount of the underlying equity, \$1,049,000, is considered to be goodwill and will be evaluated quarterly for impairment. A loss in value of the investment which is other than a temporary decline will be recognized. Evidence of a loss in value might include, but would not necessarily be limited to, absence of an ability to recover the carrying amount of the investment or inability of FNBL to sustain an earnings capacity which would justify the carrying amount of the investment.

NOTE J Subsequent Events

On October 17, 2006, the Board of Directors declared a cash dividend of \$0.17 per share to shareholders of record on November 15, 2006, payable on December 1, 2006.

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

**Forward Looking Statements:**

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words believes, anticipates, contemplates, expects, and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results, performance or achievements expressed or implied by such forward-looking statements to differ materially from those projected. Those risks and uncertainties include changes in interest rates and their impact on the level of deposits, loan demand and value of loan collateral, increased competition from other financial institutions, governmental monetary policy, legislation and changes in banking regulations, risks associated with the effect of opening a new branch, the ability to control costs and expenses, and general economic conditions. The Corporation undertakes no obligation to publicly release the results of any revisions to those forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

**Critical Accounting Policies:**

Disclosure of the Corporation's significant accounting policies is included in the notes to the consolidated financial statements of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005. Some of these policies require significant judgments, estimates, and assumptions to be made by management, most particularly in connection with determining the provision for loan losses and the appropriate level of the allowance for loan losses. Since December 31, 2005, the Corporation has added core deposit intangible assets and goodwill to its balance sheet, and considers its policies for accounting for these assets critical. The determination of goodwill and core deposit intangible is reliant upon the significant use of estimates and must be evaluated annually for impairment. As more fully discussed under Note D to the interim consolidated financial statements, Stock Option Plan, the Corporation has adopted accounting standard, FAS No. 123 (R) which was effective for the Corporation on January 1, 2006. The new accounting standard eliminated the ability of the Corporation to account for stock-based compensation under the recognition and measurement principles of APB Opinion 25; the new standard requires the Corporation to recognize in the consolidated income statement compensation cost relating to share-based payment transactions based on the fair value of the equity or liability instruments issued.

**General:**

The following discusses the consolidated financial condition of the Corporation as of September 30, 2006, as compared to December 31, 2005, and the consolidated results of operations for the three and nine months ended September 30, 2006, compared to the same periods in 2005. This discussion should be read in conjunction with the interim consolidated financial statements and related footnotes included herein.

**Introduction:**

Juniata Valley Financial Corp. is a Pennsylvania corporation organized in 1983 to become the holding company of The Juniata Valley Bank (Bank). The Bank is a state-chartered bank headquartered in Mifflintown, Pennsylvania. Juniata Valley Financial Corp. and its subsidiary bank derive substantially all of their income from banking and bank-related services, including interest earnings on residential real estate, commercial mortgage, commercial, and consumer financings, as well as interest earnings on investment securities and fee income from deposit services to its customers through 12 locations in central Pennsylvania.

**Financial Condition:**

Two events highlighting third quarter activity at Juniata Valley Financial Corp. were the consummation of the purchase of 39.16% of the outstanding common stock of the First National Bank of Liverpool (FNBL) on September 1, 2006, followed closely by the settlement of the purchase of our new Richfield, PA community office on September 8. As a result of the Richfield office addition, approximately \$20 million in deposits and \$3.8 million in loans were added to the balance sheet. The transaction is being accounted for under the purchase accounting method and, as a result a core deposit intangible and goodwill were recorded in the amounts of \$449,000 and \$2,039,000, respectively.

The investment in common stock of FNBL is being accounted for under the equity method of accounting and as such, 39.16% of FNBL's undivided profits will be included in pre-tax non-interest income from September 1, 2006 forward. As of September 30, 2006, total assets increased by \$10,212,000, or 2.5%, as compared to December 31, 2005. The increase was attributable to the purchase of the new community banking office. Net cash of approximately \$13 million received from the purchase of the office was used to fund the acquisition of the FNBL stock and to repay short-term borrowings.

Total securities available for sale at September 30, 2006 decreased \$5,284,000, or 7.9%, from December 31, 2005, as sales, maturities and principal repayments totaled \$12,851,000 during the period, with only \$7,196,000 reinvested into new available for sale securities. Net unrealized holding gains arising during the period were \$403,000, and premium amortization was \$97,000. Total securities held to maturity at September 30, 2006 increased \$5,106,000, or 146%, when compared to December 31, 2005. Total purchases of securities held-to-maturity for the period were \$5,100,000, and there were no calls, maturities or principal repayments during the period. A majority of the calls, maturities, and principal repayments in the available for sale portfolio were reinvested in the held to maturity portfolio in order to invest in tax anticipation securities.

Overall, loans, net of unearned interest, increased by \$10,355,000, or 3.5%, of which \$3,841,000 were added as part of the branch purchase. Exclusive of the purchased loans, loans grew by 2.2%. Installment loans increased \$7,049,000 or 10.0%, loans to commercial borrowers decreased \$335,000, or 0.4%, while mortgages increased \$3,641,000, or 2.7% (\$3,094,000 of this increase was from the branch purchase). Although new mortgage and commercial lending have slowed somewhat, management attributes the increases in installment lending balances to continued customer referrals, quality service and competitive rates.

As of September 30, 2006, the Corporation had one large loan relationship, with a balance of \$1,416,000, considered to be impaired for which there is a specific allocation of \$250,000 within the loan loss reserve that management believes is adequate to cover potential future losses. Otherwise, there are no material loans classified for regulatory purposes as loss, doubtful, substandard, or special mention which management expects to significantly impact future operating results, liquidity or capital resources. Following is a summary of the Bank's non-performing loans on September 30, 2006 as compared to December 31, 2005.

| <i>(Dollar amounts in thousands)</i>                           | September 30,<br>2006 | December 31,<br>2005 |
|--|-----------------------|----------------------|
| Non-performing loans   |                       |                      |
| Nonaccrual loans   | \$ 1,416              | \$ 1,515             |
| Accruing loans past due 90 days or more                        | 441                   | 724                  |
| Restructured loans   |                       |                      |
| <br>Total  | <br>\$ 1,857          | <br>\$ 2,239         |
| <br>Average loans outstanding                                  | <br>\$302,711         | <br>\$ 290,327       |
| <br>Ratio of non-performing loans to average loans outstanding | <br>0.61%             | <br>0.77%            |

Total deposits increased \$15.3 million, or 4.5%, during the first nine months of 2006. The table below shows the changes in types of deposits and the effect the branch acquisition had on each.



|                                   | <b>Balance<br/>December<br/>31,<br/>2005</b> | <b>Deposits<br/>Acquired with<br/>Branch<br/>Purchase</b> | <b>Other<br/>Changes<br/>in<br/>Deposits</b> | <b>Balance<br/>September 30,<br/>2006</b> |
|-----------------------------------|--|---|--|---|
| Deposits:                         |  |   |  |   |
| Demand, non-interest bearing      | \$ 46,041                                    | \$ 1,245  | \$ (4,063)                                   | \$ 43,223                                 |
| NOW and money market              | 68,522                                       | 3,195   | 6,294  | 78,011                                    |
| Savings                           | 43,703                                       | 1,369   | (6,484)                                      | 38,588                                    |
| Time deposits, \$100,000 and more | 39,631                                       | 2,376   | (2,473)                                      | 39,534                                    |
| Other time deposits               | 145,570                                      | 11,905  | 1,936  | 159,411                                   |
| <b>Total deposits</b>             | <b>\$343,467</b>                             | <b>\$ 20,090</b>  | <b>\$ (4,790)</b>                            | <b>\$358,767</b>                          |

The funding mix of the Corporation's deposits has been changing as lower paying and non-interest bearing core deposits continue to shift towards higher rate money market accounts and certificates of deposit. Management has continued to offer attractive, yet market-safe interest rates on deposit accounts in an effort to attract both new customers and additional deposits from existing customers. However, like most financial institutions in the current environment, the Corporation is facing challenges in growing core deposits. We believe that the sustained flat-to-inverted yield curve has resulted in an increasingly competitive pricing environment.

Securities sold under agreements to repurchase increased by \$1,741,000, or 41.4%, while short-term borrowings decreased by \$3,100,000, when comparing September 30, 2006 to September 30, 2005. Juniata has an unused borrowing capacity of \$169 million with the Federal Home Loan Bank as of September 30, 2006, as well as other avenues for borrowing from correspondent banks in order to fund additional loan demand if it continues to grow at a higher rate than deposits.

Stockholders' equity increased by \$727,000, or 1.5%, from December 31, 2005 to September 30, 2006. Net income of \$3,655,000 was offset by dividends of \$2,199,000 and net purchases of treasury stock of \$1,071,000. The Corporation repurchased stock into treasury, pursuant to its treasury repurchase program, and during the first nine months of 2006, purchased 58,082 shares, of which 8,147 shares were reissued pursuant to the Corporation's Dividend Reinvestment Plan. Additionally, 3,727 shares of treasury stock were reissued pursuant to the Employee Stock Purchase Plan. Securities available for sale increased in market value, representing an increase to equity of \$266,000 during the period.

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

Subsequent to September 30, 2006, the following event took place:

On October 17, 2006, the Board of Directors declared a cash dividend of \$0.17 per share to shareholders of record on November 15, 2006, payable on December 1, 2006.

#### **Comparison of the Three Months ended September 30, 2006 and 2005**

Operations Overview:

The third quarter's income before taxes increased by \$218,000, or 14.5%, when compared to the same period in 2005. Net interest income after provision for loan losses decreased by \$31,000, or 0.9%. Non-interest income increased \$129,000, or 15.4%, while non-interest expense decreased by \$120,000, or 4.1%. Provision for income tax was increased by \$78,000 when comparing the two quarters, resulting in an overall increase in net income of \$140,000, or 12.8%.

Presented below are selected key ratios for the two periods:



|                                       | Three Months Ended<br>September 30 |        |
|---------------------------------------|------------------------------------|--------|
|                                       | 2006                               | 2005   |
| Return on average assets (annualized) | 1.19%                              | 1.07%  |
| Return on average equity (annualized) | 10.26%                             | 8.96%  |
| Average equity to average assets      | 11.58%                             | 11.89% |

The discussion that follows further explains changes in the components of net income when comparing the third quarter of 2006 with the third quarter of 2005.

#### Net Interest Income:

Interest on loans increased \$512,000, or 10.3%, in the third quarter of 2006 as compared to the same period in 2005. An increase of \$15.1 million in the average balance of the loan portfolio, in conjunction with an average weighted interest rate increase of 33 basis points, were responsible for the higher income over the period. The growth in the loan portfolio seen during 2005 continued during 2006. Management attributes the increases in lending balances to continued customer referrals and business loan demand, the economic climate within the market area, and competitive rates. Since the purchase of loans in connection with the new branch did not occur until late in the third quarter, average loan balances for the third quarter of 2006 were increased by only \$0.9 million as a result. The growth in loans was primarily funded by proceeds from short-term borrowed funds.

Interest earned on investment securities and money market investments decreased \$12,000 in the third quarter of 2006 as compared to 2005, as average balances decreased by \$10.4 million. At the same time, due to rising rates since the third quarter of 2005, the average yield on the investment securities and the money market investments rose by 39 basis points and 76 basis points, respectively.

Interest expense on deposits increased \$424,000, or 21.1%, in the third quarter of 2006 as compared to 2005, reflecting growth in interest-bearing deposits and steadily rising interest rates. The average balance of interest-bearing deposits increased \$9,090,000, or 3.1% (\$4,857,000 from the branch acquisition), while the average interest rate paid increased to 3.16% in 2006 from 2.69% in 2005.

Total average earning assets during the third quarter of 2006 were \$386,027,000, compared to \$381,354,000 during the third quarter of 2005, yielding 6.43% in 2006 versus 5.98% in 2005. Funding costs for the earning assets were 2.68% and 2.19%, for the third quarters of 2006 and 2005, respectively. Net interest spread for the third quarter of 2006 was 3.76% and net interest margin on a fully tax-equivalent basis was 3.85%. For the same period in 2005, net interest spread and fully-tax equivalent net interest margin were 3.79% and 3.90%, respectively.

#### Provision for Loan Losses:

In the third quarter of 2006, the provision made for loan losses was \$29,000. Management regularly reviews the adequacy of the loan loss reserve and makes assessments as to specific loan impairment, historical charge-off expectations, general economic conditions in the Bank's market area, specific loan quality and other factors. In the third quarter of 2005, no loan loss provision was recorded.

#### Noninterest income:

Noninterest income increased \$129,000, or 15.4%, in the third quarter of 2006 as compared to the same period in 2005. Fees for customer service on deposit accounts in the third quarter of 2006 increased compared to the same period in 2005 by \$42,000 or 11.9% and fee income from the Bank's Alternative Investment program increased by \$38,000 or 36.2%. Income from bank owned life insurance increased in the third quarter of 2006 compared to the third quarter of 2005 by \$39,000. Income from Trust services increased by \$13,000, or 15.1%, in the third quarter of 2006 from the third quarter of 2005. The Corporation recognized no gains on sales of securities in the third quarter of 2006 as compared to gains of \$52,000 in the same quarter of 2005, and increased its gains on the sale of loans by \$19,000. Income from the unconsolidated subsidiary was \$20,000, representing the Corporation's share of the results of operations of FNBL since September 1, 2006.

As a percentage of average assets, annualized noninterest income, exclusive of net gains on the sale of securities, was 0.93% in the third quarter of 2006 as compared to 0.77% in the same period of 2005.



## Noninterest expense:

Total noninterest expense decreased \$120,000, or 4.1%, in the third quarter of 2006 as compared to 2005. Salaries and benefits costs increased by \$146,000, or 10.3%, in the third quarter of 2006 compared to the third quarter of 2005 due to factors such as the addition of staff for both the new branch office and other internal positions, higher expense for non-qualified benefit plans and expense associated with the adoption of FAS123(R), expensing of stock options. Professional fees in the third quarter of 2006 were 68.2% less than in the third quarter of 2005. Professional fees in the third quarter of 2005 were unusually high and consisted of additional costs for legal, accounting and consulting fees relating to becoming compliant with the provisions of Section 404 of the Sarbanes-Oxley Act. Costs relating to occupancy, equipment, data processing, director compensation and state taxes were not materially different in the third quarter of 2006 than in the third quarter of 2005, decreasing in the aggregate by 1.3%, however, other noninterest expense decreased by \$46,000, or 14.1%. The decrease in other noninterest expense between the two periods was primarily due to additional costs related to the free-checking product advertising promotion in 2005. As a percentage of average assets, annualized noninterest expense was 2.74% as compared to 2.89% in the same period of 2005.

**Comparison of the Nine Months ended September 30, 2006 and 2005**

## Operations Overview:

Income before taxes for the first nine months of 2006 increased by \$415,000, or 8.8%, when compared to the same period in 2005. Net interest income after provision for loan losses decreased by \$356,000, or 3.2%. Non-interest income increased \$289,000, or 11.8%, while non-interest expense decreased by \$482,000, or 5.5%. Provision for income tax was increased by \$157,000 when comparing the two periods, resulting in an overall increase to net income of \$258,000, or 7.6%.

Presented below are selected key ratios for the two periods:

|                                       | Nine Months Ended<br>September 30 |        |
|---------------------------------------|-----------------------------------|--------|
|                                       | 2006                              | 2005   |
| Return on average assets (annualized) | 1.18%                             | 1.12%  |
| Return on average equity (annualized) | 10.27%                            | 9.23%  |
| Average equity to average assets      | 11.50%                            | 12.11% |

The discussion that follows further explains changes in the components of net income when comparing the year-to-date period ending September 30, 2006 with the corresponding period in 2005.

## Net Interest Income:

Interest on loans increased \$1,372,000, or 9.3%, in the first nine months of 2006 as compared to the same period in 2005. An increase of \$14.6 million in the average balance of the loan portfolio, in conjunction with an average weighted interest rate increase of 27 basis points were responsible for the higher income over the period.

Interest earned on investment securities and money market investments decreased \$35,000 in the first nine months of 2006 as compared to 2005 as average balances decreased by \$7.8 million. At the same time, due to rising rates since June of 2005, the average yield on the investment securities and the money market investments rose by 25 basis points and 65 basis points, respectively.

Interest expense on deposits increased \$1,327,000, or 23.9%, in the first nine months of 2006 as compared to 2005, reflecting growth in deposits and steadily rising interest rates. The average balance of interest-bearing deposits increased \$9,741,000, or 3.3%, while the average interest rate paid increased to 3.05% in 2006 from 2.54% in 2005. In order to supply funding for the loan demand during the first nine months of 2006, the Corporation borrowed funds on a short-term basis from the Federal Home Loan Bank.

Total average earning assets during the first nine months of 2006 were \$383,077,000, compared to \$376,340,000 during the first nine months of 2005, yielding 6.36% in 2006 versus 6.00% in 2005. Funding costs for earning assets were 2.59% and 2.06% for the first nine months of 2006 and 2005, respectively. Net interest spread for the first nine months of 2006 was 3.77% and net interest margin on a fully tax-equivalent basis was 3.88%. For the same period in 2005, net interest spread and fully-tax equivalent net interest margin were 3.94% and 4.06%, respectively.



Provision for Loan Losses:

In the first nine months of 2006, the provision for loan losses was \$89,000. Management regularly reviews the adequacy of the loan loss reserve and makes assessments as to specific loan impairment, historical charge-off expectations, general economic conditions in the Bank's market area, specific loan quality and other factors. In the first nine months of 2005, a loan loss provision of \$28,000 was recorded.

Noninterest income:

Noninterest income increased \$289,000, or 11.8%, in the first nine months of 2006 as compared to the same period in 2005. Income from trust services increased by \$47,000, or 17.0%, in the first nine months of 2006 over the same period of 2005, primarily as a result of increased fees from non-estate relationships. Fees for customer service on deposit accounts in the first nine months of 2006 increased in comparison to the same period in 2005 by \$82,000, or 7.9%, and fee income from commissions on sales of annuities and mutual funds increased by \$83,000, or 25.7%. Income from bank owned life insurance increased in the first nine months of 2006 compared to the first nine months of 2005, by \$45,000. The Corporation recognized gains on sales of securities of \$67,000 in the first nine months of 2006, \$84,000 less than securities gains of \$151,000 in the first nine months of 2005. Exclusive of the securities gains, noninterest income increased by \$373,000, or 16.2%. Income from the unconsolidated subsidiary was \$20,000, representing the Corporation's share of the results of operations of FNBL since September 1, 2006. Other noninterest income in the first nine months of 2006 of \$435,000 exceeded other noninterest income for the same time period in 2005 by \$60,000 due primarily to fee income related to debit cards.

As a percentage of average assets, annualized noninterest income, exclusive of net gains on the sale of securities, was 0.85% in the first nine months of 2006 as compared to 0.76% in the same period of 2005.

Noninterest expense:

Total noninterest expense decreased \$482,000, or 5.5%, in the first nine months of 2006 as compared to the same period in 2005. In the second quarter of 2005 the Corporation incurred a one-time employee severance cost of \$284,000. Normal salaries and wages increased by \$162,000, or 5.0%, in the first nine months of 2006 compared to the first nine months of 2005 due to the addition of new branch staff and other new positions and employee benefit expense increased by a slight \$19,000. Data processing expense was reduced by \$48,000 in the nine months ending September 30, 2006 as compared to the same period in 2005, primarily due to the benefit of a processing credit awarded to the Corporation by the service provider. Professional fees in the first nine of 2006 were 54.6% less than in the first nine months of 2005. Professional fees in the first half of 2005 were unusually high and consisted of additional costs for legal, accounting and consulting fees relating to becoming compliant with the provisions of Section 404 of the Sarbanes-Oxley Act. Costs relating to occupancy, equipment, director compensation and state taxes were not materially different in the first nine months of 2006 than in the first nine months of 2005, decreasing in the aggregate by only \$22,000, however, other noninterest expense rose by \$31,000, or 3.7%. The increase in other noninterest expense between the two periods is primarily due to additional costs related to the free-checking product, postage and repossessed assets.

As a percentage of average assets, annualized noninterest expense was 2.70% as compared to 2.91% in the same period of 2005.

Liquidity:

The objective of liquidity management is to ensure that sufficient funding is available, at a reasonable cost, to meet the ongoing operational cash needs of the Corporation and to take advantage of income producing opportunities as they arise. While the desired level of liquidity will vary depending upon a variety of factors, it is the primary goal of the Corporation to maintain a high level of liquidity in all economic environments. Principal sources of asset liquidity are provided by securities maturing in one year or less, other short-term investments such as federal funds sold and cash and due from banks. Liability liquidity, which is more difficult to measure, can be met by attracting deposits and maintaining the core deposit base. The Corporation is a member of the Federal Home Loan Bank of Pittsburgh for the purpose of providing short-term liquidity when other sources are unable to fill these needs. During the first nine months of 2006, short-term borrowings from the Federal Home Loan Bank averaged \$6,800,000.

In August 2006, the Corporation repaid long term debt of \$5,000,000 to the Federal Home Loan Bank, which had carried a fixed interest rate of 2.86% for a two-year term. As of September 30, 2006, the Bank had no long term debt

and had unused borrowing capacity with the Federal Home Loan Bank of \$169 million.



Funding derived from securities sold under agreements to repurchase began in September of 2004 through corporate cash management accounts for business customers. This product allows the Bank an ability to pay interest on corporate checking accounts.

In view of the sources previously mentioned, management believes that the Corporation's liquidity is capable of providing the funds needed to meet loan demand.

**Off-Balance Sheet Arrangements:**

The Corporation's consolidated financial statements do not reflect various off-balance sheet arrangements that are made in the normal course of business, which may involve some liquidity risk, credit risk, and interest rate risk. These commitments consist mainly of loans approved but not yet funded, unused lines of credit, and letters of credit made under the same standards as on-balance sheet instruments. 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. Letters of credit are conditional commitments issued to guarantee the financial performance obligation of a customer to a third party. Unused commitments and letters of credit at September 30, 2006, were \$45,455,000 and \$867,000, respectively. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Corporation. Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

The Corporation has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources.

**Interest Rate Sensitivity:**

Interest rate sensitivity management is the responsibility of the Asset/Liability Management Committee. This process involves the development and implementation of strategies to maximize net interest margin, while minimizing the earnings risk associated with changing interest rates. The traditional gap analysis identifies the maturity and re-pricing terms of all assets and liabilities. A simulation analysis is used to assess earnings and capital at risk from movements in interest rates. Based on the most recent rate shock simulations, the Corporation is exposed to a loss of income if interest rates fall.

**Capital Adequacy:**

Bank regulatory authorities in the United States issue risk-based capital standards. These capital standards relate a banking company's capital to the risk profile of its assets and provide the basis by which all banking companies and banks are evaluated in terms of capital adequacy. The risk-based capital standards require all banks to have Tier 1 capital of at least 4% and total capital, including Tier 1 capital, of at least 8% of risk-adjusted assets. Tier 1 capital includes common stockholders' equity and qualifying perpetual preferred stock together with related surpluses and retained earnings. Total capital is comprised of Tier 1 capital, limited life preferred stock, qualifying debt instruments, and the reserves for possible loan losses. Banking regulators have also issued leverage ratio requirements. The leverage ratio requirement is measured as the ratio of Tier 1 capital to adjusted average assets.

At September 30, 2006, the Bank exceeded the regulatory requirements to be considered a well capitalized financial institution, i.e., a leverage ratio exceeding 5%, Tier 1 capital exceeding 6% and total capital exceeding 10%.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the risk of loss arising from changes in the fair value of financial instruments due to changes in interest rates, currency exchange rates, commodity prices or equity prices. The Corporation's market risk is composed primarily of interest rate risk. The primary objective of the Corporation's asset-liability management process is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent, appropriate and necessary to ensure profitability. The most recent financial simulation performed by the Bank as of June 30, 2006, showed a possible decline in net interest income of \$122,000 in a -100 basis point rate shock over a one-year period. If rates continue to increase, in a +100 basis point shock over a one-year period, the simulation performed shows a possible \$35,000 decrease to net interest income. The Bank is slightly liability sensitive if rates rise and slightly asset

sensitive if rates decline. This occurs because of optionality within the balance sheet. The net interest income at risk position remains within the guidelines established by the Bank's asset/liability policy. The Bank continues to monitor and manage its rate sensitivity.

No material change has been noted in the Bank's equity value at risk. Please refer to the Annual Report on Form 10-K as of December 31, 2005 for further discussion of this matter.

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

As of September 30, 2006, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to the Securities Exchange Act of 1934 ( Exchange Act ), Rule 13a-15(e). Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Corporation reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. These controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitation of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential conditions, regardless of how remote.

Attached as Exhibits 31 and 32 to this quarterly report are certifications of the Chief Executive Officer and the Chief Financial Officer required in accordance with Rule 13a-14(a) of the Exchange Act. This portion of the Corporation's quarterly report includes the information concerning the controls evaluation referred to in the certifications and should be read in conjunction with the certifications for a more complete understanding of the topics presented.

**Changes in Internal Control Over Financial Reporting**

There were no significant changes in the Corporation's internal control over financial reporting since December 31, 2005.

## **PART II OTHER INFORMATION**

### **Item 1. LEGAL PROCEEDINGS**

In the opinion of management of the Corporation, there are no legal proceedings pending to which the Corporation or its subsidiary is a party or to which their property is subject, which, if determined adversely to the Corporation or its subsidiary, would be material in relation to the Corporation's or its subsidiary's financial condition. There are no proceedings pending other than ordinary routine litigation incident to the business of the Corporation or its subsidiary. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation or its subsidiary by government authorities.

### **Item 1A. RISK FACTORS**

#### **Branch Acquisition**

The Bank has purchased the Richfield, Pennsylvania community office of the Mifflinburg Bank and Trust Company, a subsidiary of Mifflinburg Bancorp as of September 8, 2006. The transaction included approximately \$20.0 million in deposits and \$3.8 million in loans outstanding. Additionally, intangible assets were acquired, including core deposit intangible and goodwill of \$449,000 and \$2,039,000, respectively.

The branch transaction is intended to further expand the Bank's presence in Juniata County, Pennsylvania. However, there are risks in branch acquisitions. While the Bank seeks to retain the deposits assumed in the transaction, the deposit premium paid by the Bank in the transaction will apply to all of the deposits assumed in the transaction, even if some of the deposits run off in the future. Additionally, there is risk that acquired goodwill may become impaired, resulting in a charge to earnings.

Otherwise, there have been no material changes in risk factors that were disclosed in the Annual Report on Form 10-K as of December 31, 2005.

## Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information on repurchases by the Corporation of its common stock in each month of the quarter ended September 30, 2006:

| <b>Period</b>        | <b>Total<br/>Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>per Share</b> | <b>Total Number<br/>of<br/>Shares<br/>Purchased as<br/>Part of Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>Maximum<br/>Number of<br/>Shares that May<br/>Yet Be<br/>Purchased Under<br/>the<br/>Plans or Programs<br/>(1)</b> |
|----------------------|---|---|---|---|
| July 1-31, 2006      |   | \$  |   | 178,748   |
| August 1-31, 2006    | 10,000  | 21.50                                       | 10,000  | 168,748   |
| September 1-30, 2006 | 26,082  | 21.30                                       | 26,082  | 142,666   |
| Totals               | 36,082  | \$21.36                                     | 36,082  | 142,666   |

(1) On March 23, 2001, the Corporation announced plans to buy back 100,000 (200,000 on a post-split basis) shares of their stock. There is no expiration date to this buyback plan, but subsequent to the initial plan, the repurchase of 400,000 additional shares were authorized by the Board of Directors. As of November 4,

2006, the number of shares that may yet be purchased under the program was 142,666. No repurchase plan or program expired during the period covered by the table. The Corporation has no stock repurchase plan or program that it has determined to terminate prior to expiration or under which it does not intend to make further purchases.

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 Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 4.1 to the Corporation's Form S-3 registration statement no. 333-129023 filed with the SEC on October 14, 2005)

3.2 Bylaws (incorporated by reference to Exhibit 3.2 to the Corporation's report on Form 8-K filed with the SEC on February 23, 2006)

31.1 Rule 13a-14(a)/15d-14(a) Certification of President and Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32.1 Section 1350 Certification of President and Chief Executive Officer (furnished, not filed)

32.2 Section 1350 Certification of Chief Financial Officer (furnished, not filed)

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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.

Juniata Valley Financial Corp.  
(Registrant)

Date 11-08-2006

By /s/ Francis J. Evanitsky

Francis J. Evanitsky, President  
and Chief Executive Officer

Date 11-08-2006

By /s/ JoAnn N. McMinn

JoAnn N. McMinn, Chief Financial Officer