# OFFICE OF THRIFT SUPERVISION

Washington, DC 20552

# FORM 10-K

ANNUAL REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007 Office of Thrift Supervision Docket Number 7788

| UNITED STATES | THE ELMIRA SAVINGS BANK, FSB | 16-0422120 |
|---|---|---|
| (State or other jurisdiction of incorporation or organization) | (Exact name of registrant as specified in its Charter) | (IRS Employer ID Number) |

Address of Principal Executive Office: 333 East Water Street, Elmira, NY 14901
Registrant's telephone number, including area code: (607) 735-8660

Securities registered pursuant to Section 12(b) of the Act: Title of Class: Common Stock ($1,00 par value)
Securities registered pursuant to Section 12(g) of the Act. None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of Securities Act:
YES [ ] NO [X]

Indicate by check mark whether the registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 [X] NO [ ]

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

| $1.00 par value Common Stock | 1,743,538 shares |
|---|---|
| (class) | (outstanding March 10, 2008) |

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act: YES [ ] NO [X]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. [ ]

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

Large Accelerated Filer ___ Accelerated Filer ___ Non-Accelerated Filer _X_ Smaller Reporting Company ___

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):
YES [ ] NO [X]

The aggregate market value of Registrant's Common Stock held by non-affiliates as of June 30, 2007 was $33.3 million. As of June 30, 2007 there were issued and outstanding 1,448,974 shares of the Registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

| Documents | Part of 10-K into which incorporated |
|---|---|
| Definitive Proxy Statement for the April 29, 2008 Annual Meeting of Shareholders | Part III |

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## The Elmira Savings Bank, FSB
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# PART I

## Item 1 – Business

## Forward-Looking Statements

This Form 10-K contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect, and similar expressions. These forward-looking statements include:

- Statements of our goals, intentions and expectations;
- Statements regarding our business plans, prospects, growth and operating strategies;
- Statements regarding the asset quality of our loan and investment portfolios; and
- Estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions, and uncertainties, including among other things, the following important factors that could affect the actual outcome of future events:

- Significantly increased competition among depository and other financial institutions;
- Changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- General economic conditions, either nationally or in our market areas, that are worse than expected;
- Adverse changes in the securities markets;
- Legislative or regulatory changes that adversely affect our business;
- Our ability to enter new markets successfully and capitalize on growth opportunities;
- Changes in consumer spending, borrowing and saving habits;
- Changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board; and
- Changes in our organization, compensation and benefit plans.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advises readers that various factors, including those described above, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected.

Except as required by law, the Company does not undertake, and specifically disclaims any obligation, to publicly release any revisions to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

## General

Elmira Savings Bank, FSB (the Bank) was organized in 1869 as a New York chartered mutual savings bank under the name of Southern Tier Savings Bank. In 1890, the Bank's name was changed to The Elmira Savings Bank. In 1983, the Bank converted from a state charter to a federally chartered mutual savings bank. In March 1985, the Bank became a stock savings

bank with its first stock offering. The Bank conducts its business through eleven full service offices located in Chemung and Steuben Counties, New York, one office located in Tioga County, Pennsylvania, and one limited service office located in Tompkins County, New York. The main office is located at 333 East Water Street, Elmira, New York.

The Bank is engaged primarily in the business of attracting deposits from the general public and originating mortgage loans secured by first and second liens on one-to-four family residences; consumer loans on automobiles; general consumer loans; commercial real estate loans; commercial loans; and loans to finance automobile dealer floor plans. The Bank offers a wide variety of services to its individual and commercial customers.

The Bank's deposits are insured by the Federal Deposit Insurance Corporation. The Bank is chartered by the Office of Thrift Supervision and is thus subject to regulation and examination by both regulatory agencies. The Bank is also a member of the Federal Home Loan Bank System and is subject to the regulations of the Federal Reserve Board as they relate to savings institutions.

### Market Area

The Bank's market area is centered in Elmira, New York and includes the surrounding communities in the Southern Tier of New York and the Northern Tier of Pennsylvania. The Bank's market area is characterized by a stable population, moderate household incomes, and a stable and diverse industrial and service corporation base.

### Competition

The Bank faces intense competition in its market area both in attracting deposits and originating loans. This competition comes primarily from commercial banks, credit unions, brokerage companies, consumer finance companies and mortgage companies. Within the Bank's market area there are many competing banking institutions, including some substantially larger than the Bank.

The Bank competes for loans primarily on the basis of the quality of service provided to borrowers, types of loans originated, loan fees, and loan rates. The Bank competes for deposits based on the convenience of its branch locations and operating hours, quality of service, the scope of services provided, and interest rates paid on deposits.

### Regulation

The operations of the Bank and all savings institutions are significantly affected by prevailing economic conditions as well as government economic policies and regulations concerning monetary and fiscal policy, taxes, housing, financial institutions, regulatory burdens on bank products, and regulatory policy on competitors of the savings industry.

The primary regulatory authority for the Bank is the Office of Thrift Supervision ("OTS"). The OTS sets regulations on the types of loans and investments the Bank is allowed to make and hold, the types of deposit products the Bank can offer, and the activities the Bank can participate in.

Deposits of the Bank are insured by the Federal Deposit Insurance Corporation ("FDIC") up to statutory and regulatory limits, therefore, the Bank is subject to regulation, supervision and reporting requirements of the FDIC. The FDIC has adopted a regulation that defines and sets the minimum requirements for capital adequacy. Under this regulation, the Bank is required to maintain capital ratios similar to those required by the OTS.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") made significant changes to federal laws governing depository institutions and the FDIC and OTS. FDICIA requires federal bank regulatory agencies to take prompt corrective action to address the problems of undercapitalized banks.

With certain exceptions, FDICIA prohibits banks from engaging, as principals, in activities such as certain equity investments and insurance underwriting. In addition, FDICIA amends federal statutes governing extensions of credit to directors, executive officers and principal shareholders of banks, savings associations, and their holding companies; limits the aggregate amount of a financial institution's loans to insiders to the amount of the institution's unimpaired capital and surplus; restricts depository institutions that are not well capitalized from accepting brokered deposits without an express waiver from the FDIC; and amends the Home Owners Loan Act to liberalize the qualified thrift lender test. The FDICIA also required the FDIC to institute a system of risk-based deposit insurance assessments that takes into account different categories and concentrations of bank assets and liabilities.

In the fourth quarter of 1999, President Clinton signed the Gramm-Leach-Bliley Act, which makes substantial changes in the permitted relationships between banks, securities firms, insurance companies and their holding companies. The direct impact of this statute has been minimal.

The Sarbanes-Oxley Act, signed into law July 30, 2002, addresses, among other issues, corporate governance, auditor independence and accounting standards, executive compensation, insider loans, whistleblower protection, and enhanced and timely disclosure of corporate information. The SEC has adopted or proposed several implementing rules, and the NASD has proposed corporate governance rules that have been presented to the SEC for review and approval. The proposed changes are intended to allow stockholders to monitor more effectively the performance of companies and management.

Effective August 29, 2002, as directed by section 302(a) of the Sarbanes-Oxley Act, the Company's Chief Executive Officer and Chief Financial Officer are each required to certify that the Company's quarterly and annual reports do not contain any untrue statement of a material fact. This requirement has several parts, including certification that these officers are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's internal controls; that they have made certain disclosures to the Company's auditors and the Audit Committee of the Board of Directors about the Company's internal controls; and that they have included information in the Company's quarterly and annual reports about their evaluation and whether there have been significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation.

In response to the Sarbanes-Oxley Act of 2002, the Bank has established a Corporate Governance Committee, designated a financial expert on the Board of Directors, adopted a bank-wide Code of Ethical Conduct, Chief Financial Officer Code of Conduct, Director and Executive Officer Code of Conduct, and has adopted a Whistleblower policy and procedures.

## Bank Subsidiaries and Other Activities

The Bank has broad powers under both Federal law and grandfathered New York State law to create or acquire subsidiary corporations. Under the authority of grandfathered New York law, the Bank is permitted to invest the lesser of 1% of assets or 10% of capital in subsidiaries that originate and service real estate loans. In addition, the Bank may acquire subsidiaries engaged in any permissible activity other than the business of underwriting life insurance or a commercial bank or trust company. Under this power, the Bank can invest up to 1% of its assets in a single subsidiary, with an aggregate limit on such investments of 5% of assets. In addition, under both Federal and grandfathered state laws, the Bank may invest, in the aggregate, 3% of its assets in subsidiaries under its service corporation powers, and may lend additional sums to such subsidiaries. The Bank has two subsidiaries: ESB Realty Corp., a real estate investment trust; and ESB Advisory Services, Inc.

## Employees

At March 10, 2008, the Bank had 129 employees, eight of whom were part-time. None of the employees of the Bank are represented by a collective bargaining group and management considers its relations and communications with employees to be satisfactory.

## Item 1A – Risk Factors

***Our Commercial Real Estate, Commercial and Consumer Loans Expose us to Increased Lending Risks***

Commercial real estate, commercial and industrial and consumer loans expose a lender to a greater risk of loss than one-to-four-family residential loans. Commercial real estate and commercial and industrial loans typically involve larger loan balances to single borrowers or groups of related borrowers compared on one-to-four-family residential loans. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to one residential mortgage loan. Similarly, consumer loans generally have a higher credit risk than residential loans due to the loan being unsecured or secured by rapidly depreciable assets. See the *Business – Loan Portfolio* section of this Form 10-K.

***If our Allowance for Loan Losses is not Sufficient to Cover Actual Loan Losses, our Earnings could Decrease***

Our loan customers may not repay their loans according to their terms, and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. We may experience significant loan losses, which could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we rely on an allowance valuation model that considers a review of loans, our experience and our evaluation of economic conditions. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance. Material additions to our allowance would materially decrease our net income.

In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities could have a material adverse effect on our results of operations and financial condition. See the *Business-Lending Activities – Allowance for Loan Losses* section of this Form 10-K.

***Our Local Economy has Limited Growth Potential and this may Hurt our Ability to Generate Profits and Grow our Business***

The success of our business depends on our ability to generate profits and grow our franchise. Our primary market area in the southern tier of New York has experienced a decline in population, reflecting a decrease in the manufacturing sector, and the loss of major employers during the past decade. Moreover, economic and population growth in the southern tier of New York is expected to be limited for the foreseeable future. The relatively weak economy will make it more difficult for us to grow our earnings and to generate internal asset growth.

***Changes in Market Interest Rates could Adversely Affect our Results of Operations and Financial Condition***

Our results of operations and financial condition are significantly affected by changes in interest rates. Our results of operations are substantially dependent on our net interest income, which is the difference between the interest income earned on our interest-earning assets and the interest expense paid on our interest-bearing liabilities. Because as a general matter our interest-bearing liabilities reprice or mature more quickly than our interest-earning assets, an increase in interest rates generally would result in a decrease in our average interest rate spread and net interest income.

Changes in interest rates also affect the value of our interest-earning assets, and in particular, our securities portfolio. Generally, the value of debt securities fluctuates inversely with changes in interest rates. Changes in the unrealized gains and losses on our securities available-for-sale could have an adverse effect on stockholders' equity. The yield curve was inverted on December 31, 2007. If it inverts even further, this would cause even greater pressure on our net interest margin.

We are also subject to reinvestment risk relating to interest rate movements. Changes in interest rates can affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in prepayments of loans and mortgage-related securities, as borrowers refinance to reduce borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest such prepayments at rates that are comparable to the rates on existing loans or securities.

***If Economic Conditions Deteriorate, our Results of Operations and Financial Condition could be Adversely Impacted as Borrowers' Ability to Repay Loans Declines and the Value of the Collateral Securing our Loans Decreases***

Our financial results may be adversely affected by changes in prevailing economic conditions, including decreases in real estate values, adverse employment conditions, the monetary and fiscal policies of the federal government and other significant external events. Because we have a significant amount of real estate loans, decreases in real estate values could adversely affect the value of property used as collateral. Adverse changes in the economy may also have

a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings.

In addition, substantially all of our loans are to individuals and businesses in Chemung, Schuyler, Steuben, Tioga, Tompkins, and Cayuga Counties, New York, and Tioga County Pennsylvania. Consequently, any decline in the economy of these market areas could have an adverse impact on our earnings.

***Strong Competition within our Market Area may Limit our Growth and Profitability***

Competition in the banking and financial services industry is intense. The southern tier of New York has a high concentration of financial institutions, including large money center and regional banks, community banks, and credit unions. Some of our competitors offer products and services that we currently do not offer, such as private banking. Some of these competitors have substantially greater resources and lending limits than we do and may offer certain services that we do not or cannot provide. This competition has made it more difficult for us to make new loans and at times has forced us to offer higher deposit rates. Price competition for loans and deposits might result in us earning less on our loans and paying more on our deposits, which reduces net interest income. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability depends upon our continued ability to successfully compete in our market area.

***We may have Difficulty Managing our Growth, which may Divert Resources and Limit our Ability to Successfully Expand our Operations***

We have incurred substantial expenses to build our management team and personnel, develop our delivery systems, and establish our infrastructure to support future growth. Our future success will depend on the ability of our officers and key employees to continue to implement and improve our operational, financial and management controls, reporting systems, and procedures, and to manage a growing number of client relationships. We may not be able to successfully implement improvements to our management information and control systems in an efficient or timely manner, and we may discover deficiencies in our existing systems and controls. Thus, we cannot assure you that our growth strategy will not place a strain on our administrative and operational infrastructure or require us to incur additional expenditures beyond current projections to support our recent and future growth.

***A Breach of Information Security could Negatively Affect our Earnings***

Increasingly, we depend upon data processing, communication, and information exchange on a variety of computing platforms and networks, and over the Internet. We cannot be certain all our systems are entirely free from vulnerability to attack, despite safeguards we have instituted. In addition, we rely on the services of a variety of vendors to meet our data processing and communication needs. If information security is breached, information can be lost or misappropriated, resulting in financial loss or costs to the Bank or damages to others. These costs or losses could materially exceed the amount of insurance coverage, if any, which would adversely affect our earnings.

***We Operate in a Highly Regulated Environment and we may be Adversely Affected by Changes in Laws and Regulations***

We are subject to extensive regulation, supervision, and examination by the Office of Thrift Supervision, our chartering authority. Such regulation and supervision govern the activities in which an institution may engage and are intended primarily for the protection of the depositors. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operating of an institution, the classification of assets by the institution, and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, could have a material impact on the Bank. During 2009 the Bank must comply with additional requirements of the Sarbanes-Oxley legislation. This compliance may result in additional costs to the Bank, which would negatively affect Bank earnings.

***Changes in the Value of Goodwill and Other Intangible Assets Could Negatively Affect our Earnings***

Under accounting standards, the Company is not required to amortize goodwill but rather must evaluate goodwill for impairment at least annually. If deemed impaired at any point in the future, an impairment charge representing all or a portion of goodwill will be recorded to current earnings in the period in which the impairment occurred. The capitalized value of other intangible assets is amortized to earnings over their estimated lives. Other intangible assets are also subject to periodic impairment reviews. If these assets are deemed impaired at any point in the future, an impairment charge will be recorded to current earnings in the period in which the impairment occurred. See also Note 10 of the Notes to Consolidated Financial Statements.

***Integration of Acquisitions***

The Bank periodically reviews potential acquisition opportunities involving other financial institutions and financial services companies. The Bank seeks merger or acquisition partners that are culturally similar, present long-term growth opportunities, and have the potential for improved profitability through economies of scale or expanded services. Risks associated with acquisitions include potential exposure to asset quality issues of the acquired entity, the difficulty and expense of integrating the operations and personnel of the acquired entity, potential disruption to the business of the acquired entity, potential diversion of management time and attention from other matters, and impairment of relationships with, and the possible loss of, key employees and customers of the acquired entity. Failure to realize expected revenue increases, cost savings, and/or other projected benefits from an acquisition could have a material adverse effect on the Bank's financial condition and results of operations.

***New York State Taxation***

The 2008 New York State Proposed Budget Bill includes a provision that may impact the taxation of the Bank and its subsidiaries. If passed in its current form, the bill would disallow the 60% exclusion for dividends paid by a real estate investment trust ("REIT") if an Article 9A subsidiary is included in a company's combined tax return. The Bank has an Article 9A subsidiary, ESB Advisory Services, and therefore may be negatively impacted by the proposed legislation.

## Item 2 – Properties

The Bank has a main office, including administrative offices, ten full service branch offices, one loan center, and other properties. At December 31, 2007, management believes the Bank's existing properties are adequate for the conduct of its business. The following table sets forth certain information relating to the Bank's offices and other properties at December 31, 2007:

| Location | Year Opened | Owned or Leased | Lease Expiration | Lease Renewal Option | Net Book Value (000's) |
|---|---|---|---|---|---|
| Main Office<br>333 E. Water Street, Elmira, NY | 1975 | Owned | -- | -- | 1,973 |
| Horseheads Branch<br>Grand Central Avenue, Horseheads, NY | 1969 | Owned | -- | -- | 361 |
| West Elmira Branch<br>West Church Street, Elmira, NY | 1977 | Owned | -- | -- | 195 |
| Southport Branch<br>Pennsylvania Avenue, Elmira, NY | 1980 | Owned | -- | -- | 296 |
| Arnot Mall Branch<br>Rt. 17 & Chambers Road, Big Flats, NY | 1980 | Leased | 2012 | Yes | 209 |
| Mansfield Branch<br>1485 South Main Street, Mansfield, PA | 1993 | Owned | -- | -- | 291 |
| Corning Branch<br>19 E. Market Street - Suite 101, Corning, NY 14830 | 2006 | Leased | 2011 | Yes | 21 |
| Commons Branch<br>301 East State Street, Ithaca, NY 14850 | 2007* | Leased | 2011 | Yes | 0 |
| Moravia Branch<br>142 Main Street, Moravia, NY | 2007* | Owned | -- | -- | 235 |
| South Meadow Branch<br>702 South Meadow Street, Ithaca, NY | 2007* | Leased | 2017 | Yes | 601 |
| Triphammer Branch<br>2300 North Triphammer Road, Ithaca, NY | 2007* | Leased | 2012 | Yes | 108 |
| Ithaca Loan Center<br>Suite 5, 840 Hanshaw Road, Ithaca, NY | 2004 | Leased | 2008 | Yes | 29 |
| Multiple-Use Building<br>311, 313, 315 East Water Street, Elmira, NY | -- | Owned | -- | -- | 551 |
| Building lots held for possible future use<br>Division Street & Lackawanna Avenue, Elmira, NY | -- | Owned | -- | -- | 295 |
| Parking Lot<br>100-106 Lake Street, Elmira, NY | -- | Owned | -- | -- | 172 |

*Properties noted with an asterisk were acquired through a 2007 business combination.

## Item 3 – Legal Proceedings

There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company or its subsidiary is a party or of which any of their property is the subject.

## Item 4 – Submission of Matters to a Vote of Security Holders

A vote was submitted to shareholders at a special shareholder meeting held on October 30, 2007. The shareholders approved by a majority vote a motion to allow officers and directors to participate in the private placement common stock offering. The shareholders also approved by a majority the issuance of up to 600,000 additional shares of common stock at $21.00 per share. Although both of these motions were approved, directors and officers of the Bank did not participate in the offering and only 287,376 shares, less than 20% of issued and outstanding

shares, were issued through the offering. Due to disclosure issues raised by the OTS and time constraints involved in raising the capital, the Bank did not take action on the motions that were approved at the meeting.

# PART II

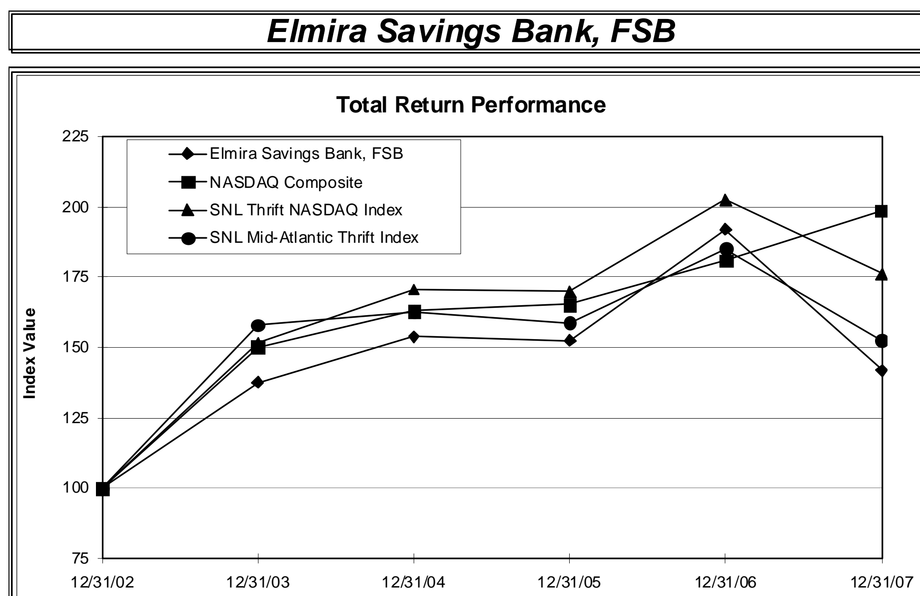
## Item 5 – Market for Registrant's Common Equity and Related Shareholder Matters

The Bank's common stock was first offered in March 1985 and is now listed on the NASDAQ exchange. The table below summarizes the high and low market price for the Bank's stock during 2007 and 2006 and includes the effect of a 10 percent stock dividend distributed to shareholders of record on June 22, 2007.

During the fourth quarter of 2007, the Bank conducted a private placement offering for its common stock. Pursuant to that offering, the Bank issued 287,376 shares at $21.00 per share. The net proceeds of the issuance were $5.9 million. The shares were issued to 75 new and existing shareholders. No shares were issued to directors or officers.

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| 1st Quarter | 30.24 | 25.97 | 22.24 | 21.05 |
| 2nd Quarter | 27.51 | 22.51 | 25.01 | 21.26 |
| 3rd Quarter | 23.87 | 19.25 | 28.16 | 23.64 |
| 4th Quarter | 21.98 | 18.50 | 28.92 | 26.14 |

The Bank had 526 holders of record of common stock at March 10, 2008, and the brokers currently making a market in the Bank's common stock are: Stifel Nicolaus; Spear, Leeds & Kellogg; Moors & Cabot; Baird Patrick; and Howe Barnes.




Information regarding securities authorized for issuance under equity compensation plans is provided in Part III "Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" of this report.

## Item 6 – Selected Financial Data

| | At or for the years ended December 31, (dollars in thousands, except per share data) | | | | |
|---|---|---|---|---|---|
| **Consolidated balance sheet data:** | **2007** | **2006** | **2005** | **2004** | **2003** |
| Total assets | $453,687 | $371,420 | $333,322 | $318,964 | $284,654 |
| Securities available for sale | 88,670 | 91,846 | 95,538 | 91,434 | 71,556 |
| Securities held to maturity | 7,273 | 7,959 | 8,482 | 9,220 | 7,797 |
| Loans, net of deferred loan costs | 299,887 | 226,381 | 206,471 | 197,412 | 181,933 |
| Allowance for loan losses | 2,478 | 1,665 | 2,095 | 1,965 | 2,459 |
| Deposits | 356,424 | 288,772 | 241,719 | 248,563 | 232,478 |
| Borrowings | 52,776 | 55,846 | 65,912 | 44,773 | 27,030 |
| Shareholders' equity | 41,019 | 24,634 | 22,785 | 22,275 | 22,121 |
| **Consolidated income statement data:** | | | | | |
| Interest income | $22,729 | $19,026 | $16,817 | $15,750 | $15,595 |
| Interest expense | 12,177 | 9,168 | 6,562 | 5,307 | 5,605 |
| Net interest income | 10,552 | 9,858 | 10,255 | 10,443 | 9,990 |
| Provision (credit) for loan losses | 525 | (290) | 155 | 165 | 620 |
| Noninterest income | 2,559 | 1,013 | 2,582 | 2,038 | 2,604 |
| Noninterest expense | 9,799 | 8,863 | 8,548 | 8,384 | 8,138 |
| Income before income tax | 2,787 | 2,298 | 4,134 | 3,932 | 3,836 |
| Income tax expense | 692 | 604 | 1,352 | 1,332 | 1,393 |
| Net income | $2,095 | $1,694 | $2,782 | $2,600 | $2,443 |
| **Per share data:** | | | | | |
| Basic earnings per share | $1.34 | $1.16 | $1.91 | $1.77 | $1.61 |
| Diluted earnings per share | $1.33 | $1.15 | $1.89 | $1.75 | $1.59 |
| Cash dividends declared per share | $0.83 | $0.72 | $0.62 | $0.55 | $0.50 |
| **Other data:** | | | | | |
| Return on average assets | 0.54% | 0.49% | 0.86% | 0.85% | 0.85% |
| Return on average shareholders' equity | 7.85% | 7.30% | 12.46% | 12.07% | 11.35% |
| Shareholders' equity to assets at year-end | 9.04% | 6.63% | 6.84% | 6.98% | 7.77% |
| Dividend payout ratio | 61.94% | 62.07% | 32.46% | 31.07% | 31.06% |
| Number of offices | 12 | 8 | 7 | 7 | 6 |

Per share data has been restated to reflect a 10% stock dividend paid on June 22, 2007.

## Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations should be read in conjunction with the audited consolidated financial statements and notes.

## General

The financial review which follows focuses on the factors affecting the financial condition of The Elmira Savings Bank, FSB during the years ended December 31, 2007 and 2006 and the results of operations for the three years ended December 31, 2007. The consolidated financial statements and related notes as of December 31, 2007, and for each of the years in the three-year period ended December 31, 2007, should be read in conjunction with this review. All per share data has been restated to reflect a 10% stock dividend paid on June 22, 2007.

Our results of operations are dependent primarily on net interest income, which is the difference between the income earned on our loans and securities and our cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by the provision (credit) for loan losses, securities and loan sale activities, loan servicing activities, service charges and fees collected on our deposit accounts.

Our noninterest expense primarily consists of salaries and employee benefits, occupancy and equipment expense, marketing expense, technology expense and other expenses. Results of operations are also significantly affected by general economic and competitive conditions, particularly changes in interest rates, government policies and the actions of regulatory authorities.

The Bank's primary regulator is the Office of Thrift Supervision ("OTS"), and its customers' deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to the maximum amount permitted by FDIC regulation. The Bank is subject to regulations and periodic examinations by both of these regulatory agencies. Additionally, the Bank is also subject to regulations issued by the Board of Governors of the Federal Reserve System.

The Bank's common stock is traded on the NASDAQ exchange under the symbol ESBK. The table below summarizes the quoted market prices for the Bank's stock during 2007.

| **2007 Bid** | High | Low |
|---|---|---|
| | 30.00 | 16.86 |
| **2007 Ask** | High | Low |
| | 31.00 | 18.90 |

## 2007 Highlights

Total assets were $453.7 million at December 31, 2007, which was $82.3 million or 22.1% above December 31, 2006. Net loans increased by $73.5 million and total investments decreased by $3.9 million. The increase in loans is attributable to a $46.1 million increase in real estate loans, a $12.7 million increase in consumer loans, and a $14.3 million increase in business loans. Deposits increased by $67.7 million or 23.4% during the year. Borrowings decreased by $3.1 million or 5.5% during 2007.

The deposit and loan growth is primarily attributable to a business combination that occurred in the fourth quarter of 2007. This transaction resulted in the Bank acquiring $35.3 million of loans and $78.0 million of deposits, along with four full service branches in Tompkins and Cayuga Counties, New York.

During the fourth quarter the Bank conducted a private placement for common stock as well as preferred stock. The result of these placements was the issuance of 287,376 shares of common stock with net proceeds of $5.9 million and issuance of 10,000 shares of preferred stock with net proceeds of $9.7 million, increasing the Bank's shareholder equity to $41.0 million.

Net income for the year ended December 31, 2007 was $2.1 million or $1.33 per diluted share, which was $.4 million or 23.7% higher than the same period in 2006. This increase is due to a

$.7 million increase in net interest income, combined with a $1.5 million increase in noninterest income, which was partially offset by a $.9 million increase in noninterest expense and a $.8 million increase in the provision for loan losses. Return on assets and return on equity were .54 percent and 7.85 percent, respectively, for the year ended 2007, compared to .49 percent and 7.30 percent, respectively, for the same period in 2006.

In December 2006, following an evaluation of its available for sale securities and in light of changing market conditions, management determined to sell $34 million dollars of callable agency bonds and mortgage-backed securities which had a book yield of 4.14%. In order to liquidate the investments, the Bank recognized a $916,000 loss on sale of securities. This loss was included in noninterest income in 2006.

## Critical Accounting Policies

The accounting and reporting policies of Elmira Savings Bank conform to accounting principles generally accepted in the United States of America and reporting practices followed by the banking industry. Elmira Savings Bank utilizes the accrual method of accounting for financial reporting purposes.

Our most critical accounting policies relate to the provision (credit) for loan losses and related allowance for loan losses and impairment considerations related to goodwill.

Elmira Savings Bank provision (credit) for loan losses charged or credited to operations is based upon management's evaluation of the loan portfolio. The allowance for loan losses is maintained at a level that management believes, to the best of its knowledge, is at a level at each reporting date, that is adequate based upon the estimated inherent risk of loss in the current loan portfolio. Management's judgment is based upon, but not limited to, periodic evaluation of the portfolio, past loss experience and current economic conditions. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review Elmira Savings Bank's allowance for loan losses. Such agencies may require Elmira Savings Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examinations.

Interest and dividend income on loans, securities and other interest-earning assets is accrued monthly unless management considers the collection of interest to be doubtful. When loans are placed on nonaccrual status, any accrued but unpaid interest is reversed by charging interest income. While a loan is classified as nonaccrual and the future collectibility of the recorded loan balance is uncertain, any payments received are generally used to reduce the principal balance. When the future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. Loans are returned to accrual status when collectibility is no longer considered doubtful.

Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment, or more often if certain conditions or events occur, and any such impairment will be recognized in the period identified. In 2007 the Bank recorded goodwill in connection with the purchase of four branch offices located in central New York State.

## Acquisition and Goodwill

On December 3, 2007, the Bank completed the acquisition of four branches in the counties of Tompkins and Cayuga. This acquisition was accounted for as a business combination in accordance with Statement of Financial Accounting Standards No. 141 ("SFAS No. 141".) As a result of this acquisition, the Bank received $28.0 million related to the net liabilities assumed in the acquisition. The results of operation of the acquired branches are included in the Bank's consolidated financial statements from the date of acquisition. The identified intangible asset from this acquisition is a core deposit intangible of $1.2 million which is being amortized over ten years on an accelerated basis. Goodwill resulting from the acquisition was $12.3 million. The fair value of assets acquired and liabilities assumed in the acquisition are as follows:

| (in thousands) | | Fair Value |
|---|---|---|
| Loans | $ | 35,278 |
| Cash | | 28,041 |
| Goodwill | | 12,295 |
| Core Deposit intangible | | 1,192 |
| Premises and equipment | | 1,062 |
| Accrued interest receivable and other assets | | 200 |
| Total Assets | $ | 78,068 |
| Certificates of Deposits | $ | 43,856 |
| Other Deposits | | 34,212 |
| Total Liabilities | $ | 78,068 |

## Financial Condition

Unless otherwise noted, the following discussion compares the Bank's financial condition at December 31, 2007 to December 31, 2006.

At December 31, 2007, the Bank had total consolidated assets of $453.7 million, an increase of $82.3 million or 22.1 percent from the December 31, 2006 level of $371.4 million. The Bank increased its loan portfolio by $73.5 million (32.5 percent.) The Bank experienced an increase in deposits of $67.7 million (23.4 percent) and a decrease in borrowings by $3.1 million (5.5 percent).

The balance growth is primarily attributable to a business combination, which occurred in the fourth quarter of 2007. This transaction resulted in the Bank acquiring $35.3 million of loans, $78.0 million of deposits, along with four full service branches in Tompkins and Cayuga Counties, New York.

Total earning assets increased to 90.9 percent of total assets at December 31, 2007 from 89.2 percent at December 31, 2006. Securities and loans represented 21.8 percent and 65.6 percent, respectively, of total assets at December 31, 2007, as compared to 27.7 percent and 60.5 percent, respectively, at December 31, 2006. Total liabilities increased by $65.9 million to $412.7 million at December 31, 2007 from $346.8 million at December 31, 2006. Total deposits increased by $67.7 million to $356.4 million. For 2007, this increase in deposits is due primarily to time deposit and NOW account growth of $29.8 million and $19.3 million, respectively. Total borrowings decreased by $3.1 million to $52.8 million. Total deposits funded 78.6 percent of total assets at year-end 2007 in comparison to 77.7 percent at December 31, 2006. The percentage of total assets supported by borrowings decreased to 11.6 percent at December 31, 2007 from 15.0 percent at the prior year-end.

Total shareholders' equity was $41.0 million at December 31, 2007, an increase of $16.4 million, or 66.5 percent from December 31, 2006. See discussion of "Capital Resources" included herein.

During the fourth quarter of 2007 the Bank conducted a private placement offering for its common stock. Pursuant to that offering, the Bank issued 287,376 shares at $21.00 per share. The net proceeds of the issuance were $5.9 million. The shares were issued to 75 new and existing shareholders. No shares were issued to directors or officers.

Additionally during the fourth quarter, to raise sufficient capital for the business combination, the Bank issued 10,000 shares of nonvoting, noncumulative, perpetual preferred stock. The shares were issued to one investor and the issuance generated $9.7 million of capital.

## Loan Portfolio

Loans receivable (after net unamortized loan origination costs and before the allowance for loan losses) at December 31, 2007 increased to $299.9 million and were $73.5 million (32.5 percent) higher than December 31, 2006 levels. The composition of the net increase in the loan portfolio consisted of a $24.2 million increase in residential real estate loans, a $20.5 million increase in commercial real estate loans, a $14.3 million increase in commercial loans, a $12.7 million increase in consumer loans and a $1.5 million increase in construction loans.

The branch acquisition resulted in the purchase of consumer loans which had a fair value of $8.2 million. Additionally, the Bank acquired commercial real estate loans which had a fair value of $27.6 million.

Loans held for sale at December 31, 2007 were $95,000. The Bank did not have any loans held for sale at December 31, 2006.

At December 31, 2007, the Bank's loan portfolio before net unamortized loan costs and the allowance for loan losses consisted of the following: $192.6 million of real estate loans; $49.8 million of business loans; and $56.9 million of consumer loans.

The following table sets forth the classification of the Bank's loan portfolio at December 31:

| | 2007 | | 2006 | | 2005 | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | $ Outstanding | % of Total Loans | $ Outstanding | % of Total Loans | $ Outstanding | % of Total Loans |
| Residential real estate loans | 130,409 | 43.6 | 106,162 | 47.0 | 96,234 | 46.7 |
| Commercial real estate loans | 59,197 | 19.8 | 38,656 | 17.1 | 40,248 | 19.5 |
| Construction loans | 3,019 | 1.0 | 1,529 | 0.7 | 2,756 | 1.3 |
| Commercial loans | 49,842 | 16.6 | 35,556 | 15.7 | 28,385 | 13.8 |
| Automobile Floorplan loans | 0 | 0.0 | 0 | 0.0 | 483 | 0.2 |
| Consumer loans | 56,907 | 19.0 | 44,198 | 19.5 | 38,159 | 18.5 |
| | 299,374 | 100.0 | 226,101 | 100.0 | 206,265 | 100.0 |

| | 2004 | | 2003 | |
|---|---|---|---|---|
| (dollars in thousands) | $ Outstanding | % of Total Loans | $ Outstanding | % of Total Loans |
| Residential real estate loans | 92,397 | 46.8 | 69,958 | 38.5 |
| Commercial real estate loans | 36,269 | 18.4 | 38,537 | 21.2 |
| Construction loans | 3,487 | 1.8 | 4,533 | 2.5 |
| Commercial loans | 29,577 | 15.0 | 25,300 | 13.9 |
| Automobile Floorplan loans | 462 | 0.2 | 5,799 | 3.2 |
| Consumer loans | 35,071 | 17.8 | 37,647 | 20.7 |
| | 197,263 | 100.0 | 181,774 | 100.0 |

Consumer loan originations totaled $27.6 million in 2007 compared to $23.1 million in 2006. Indirect auto loan originations included in consumer loans decreased by $1.0 million from $5.5 million for 2006 to $4.5 million for 2007. Residential real estate loan originations totaled $40.4 million in 2007, an increase of $10.6 million or 36 percent from originations of $29.8 million in 2006. Commercial loan and commercial real estate loan originations totaled $20.4 million in 2007 versus $18.4 million in 2006.

## Nonperforming Assets

As a matter of policy, the Bank discontinues accrual of interest when loan payments are 90 days or more past due (unless well secured and in the process of collection), or when by judgment of management, collectibility is uncertain. The following table sets forth certain information concerning the Bank's nonperforming loans, other real estate owned, and repossessed automobiles at the dates indicated:

| | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| | | | (dollars in thousands) | | |
| Nonaccrual loans | $ 2,238 | $ 110 | $ 659 | $ 411 | $ 1,672 |
| Loans past due 90 days or more and still accruing | - | - | - | - | - |
| Total nonperforming loans | 2,238 | 110 | 659 | 411 | 1,672 |
| Other real estate owned | 7 | 178 | - | 142 | 62 |
| Other repossessed assets | 8 | 32 | 25 | 26 | 32 |
| Total nonperforming assets | $ 2,253 | $ 320 | $ 684 | $ 579 | $ 1,766 |
| Nonperforming loans as a percentage of loans receivable, net | 0.75% | 0.05% | 0.32% | 0.21% | 0.92% |
| Nonperforming assets as a percentage of total assets | 0.50% | 0.09% | 0.21% | 0.18% | 0.62% |

The increase in nonaccruing loans at December 31, 2007 primarily relates to an increase in impaired loans. Impaired loans at December 31, 2007 totaled $1.9 million with no impaired loans at December 31, 2006. Included in impaired loans at December 31, 2007 are $1.7 million of loans that had a related allowance for loan losses of $442,000 and $.2 million of loans that had no related allowance for loan losses due to the adequacy of collateral or previous charge-offs taken. The $1.9 million of impaired loans at December 31, 2007 are made up of a few commercial real estate loans which the Bank believes have sufficient collateral and/or have an adequate level of allowance for loan losses related to them.

At December 31, 2007 loans more than 30 days delinquent, excluding nonaccrual loans, amounted to .38 percent of total loans receivable, net, as compared to .35 percent of total loans receivable, net at December 31, 2006.

At December 31, 2007, in addition to nonperforming loans, the Company, through its internal loan review function, has identified 16 commercial relationships totaling $5.0 million, which it has classified as substandard. At December 31, 2006, the Bank had nine commercial relationships totaling $4.2 million, which it had classified as substandard. These loans remain in a performing status due to a variety of factors, including payment history, the value of collateral supporting the credits, and personal guarantees. While in a performing status as of December 31, 2007, these loans exhibit certain risk factors, which have the potential to cause them to become nonperforming. Accordingly, management's attention is focused on these potential problem loans which are reviewed on at least a quarterly basis.

## Allowance for Loan Losses

The allowance for loan losses is maintained at a level that management considers adequate to provide for the inherent risk of loss in the current loan portfolio. Management's evaluation is based on a continuing review of the loan portfolio that includes many factors, such as identification of adverse situations that affect a borrower's ability to repay, a review of overall portfolio quality, and an assessment of current economic conditions.

At December 31, 2007, the allowance for loan losses amounted to $2.5 million and represented .83 percent of loans receivable, net. At December 31, 2006, the allowance for loan losses was $1.7 million and represented .74 percent of loans receivable, net. As a result of the business combination, which occurred during 2007, the Bank acquired $27.6 of commercial mortgages and $8.2 of consumer loans. Included in the acquisition was $521,000 of allowance for loan losses related to the acquired loans.

The following table presents the activity in the allowance for loan losses for the years ended December 31:

| (dollars in thousands) | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| Balance at beginning of year | $1,665 | $2,095 | $1,965 | $2,459 | $1,961 |
| Loan charge-offs | | | | | |
| Real Estate loans | (55) | (59) | (23) | (204) | (78) |
| Commercial loans | (97) | (78) | (154) | (644) | (1) |
| Consumer loans | (137) | (147) | (125) | (151) | (290) |
| Total loans charged-off | (289) | (284) | (302) | (999) | (369) |
| Loan recoveries | | | | | |
| Real Estate loans | 0 | 18 | 24 | 25 | 36 |
| Commercial loans | 0 | 3 | 72 | 148 | 1 |
| Consumer loans | 56 | 123 | 181 | 167 | 210 |
| Total loans recovered | 56 | 144 | 277 | 340 | 247 |
| Net charge-offs | (233) | (140) | (25) | (659) | (122) |
| Allowance acquired in business combination | 521 | - | - | - | - |
| Provision charged (credited) to expense | 525 | (290) | 155 | 165 | 620 |
| Balance at end of year | $2,478 | $1,665 | $2,095 | $1,965 | $2,459 |
| Allowance to total loans at end of period | 0.83% | 0.74% | 1.01% | 1.00% | 1.35% |
| Net charge-offs to average loans outstanding | (0.09%) | (0.07%) | (0.01%) | (0.35%) | (0.06%) |

During 2006, the credit to the provision for loan allowance was due primarily to the Bank receiving a $2.6 million paydown on a $2.7 million commercial real estate credit that had been classified substandard. The increase in nonaccrual loans from $.3 million in 2006 to $2.3 million in 2007 combined with the increase in delinquencies resulted in the Bank's provision for loan losses being $525,000 compared to a credit of $290,000 in 2006.

The following table is an allocation of the loan loss allowance by loan type:

| | December 31, | | | | |
|---|---|---|---|---|---|
| (in thousands) | 2007 | 2006 | 2005 | 2004 | 2003 |
| Commercial real estate loans | $ 964 | $ 369 | $ 858 | $ 909 | $ 1,044 |
| Residential real estate loans | 406 | 179 | 209 | 165 | 199 |
| Commercial loans | 777 | 574 | 582 | 378 | 801 |
| Consumer loans | 331 | 230 | 87 | 78 | 93 |
| Unallocated | - | 313 | 359 | 435 | 322 |
| Balance at end of year | $ 2,478 | $ 1,665 | $ 2,095 | $ 1,965 | $ 2,459 |

The above allocation is not indicative of the specific amounts on the loan categories in which future charge-offs may occur, nor is it an indicator of future loss trends. The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category.

The reduction in the unallocated allowance for loan losses in 2007 is due to the evaluation of certain qualitative considerations related to the total loan portfolio in the unallocated category prior to 2007 and the evaluation of these qualitative considerations by loan type in 2007.

## Securities

The Bank's investment strategy is to maintain a securities portfolio that: provides a source of liquidity through maturities, provides collateralization for borrowings and selling opportunities; contributes to the Bank's overall profitability; and provides a balance to interest rate and credit risk in other categories of the balance sheet. The Bank does not maintain a trading account and does not engage in derivative activities in carrying out its investment strategy. At December 31, 2007 and 2006, the Bank's securities portfolio consisted primarily of U.S. Government sponsored enterprises and U. S. Government sponsored enterprises mortgage-backed securities ("MBS") that provide high quality and low credit risk to the overall balance sheet mix. At December 31, 2007, all but $7.3 million of the Bank's total portfolio of $95.9 million is classified as available for sale in order to: (i) provide management with the flexibility to make adjustments to the portfolio given changes in the economic and/or interest rate environment; (ii) to fulfill unanticipated liquidity needs; or (iii) to take advantage of alternative opportunities.

In December 2006, following an evaluation of its available for sale securities and due to our anticipation that a return to a normal yield curve would not occur until 2008, management determined to sell $34 million of callable agency bonds and mortgage-backed securities which had a book yield of 4.14%. These investments were sold and the proceeds were reinvested in similar investments, which have a current yield of approximately 5.50%. In order to liquidate the investments, the Bank recognized a $916,000 loss on sale of securities.

The following table sets forth certain information concerning the Bank's securities portfolio for the years ended:

| (in thousands) | 2007 | 2006 | 2005 |
|---|---|---|---|
| Securities available for sale: | | | |
| Fair Value: | | | |
| U.S. Government Sponsored Enterprises | $ 19,958 | $ 37,814 | $ 32,235 |
| Mortgage-backed securities | 53,132 | 39,436 | 56,626 |
| Municipal securities | 15,580 | 14,596 | 6,677 |
| Total of securities available for sale | $ 88,670 | $ 91,846 | $ 95,538 |
| | | | |
| Securities held to maturity: | | | |
| Amortized cost: | | | |
| U.S. Government Sponsored Enterprises | $ 2,000 | $ 2,000 | $ 2,000 |
| Mortgage-backed securities | 1,739 | 2,364 | 2,808 |
| Municipal securities | 3,166 | 3,283 | 3,394 |
| Other debt securities | 368 | 312 | 280 |
| Total of securities held to maturity | $ 7,273 | $ 7,959 | $ 8,482 |

The average yield on the U.S. Government sponsored enterprises obligations available for sale at December 31, 2007 was 4.94%. The average yield on mortgage-backed securities available for sale at December 31, 2007 was 4.98%. The average yield on municipal securities available for sale on December 31, 2007 was 4.17%.

The following table presents a maturity distribution at amortized cost for securities available for sale and the weighted average yield for each type and range of maturity as of December 31, 2007:

| (in thousands) | Government Sponsored Enterprises | | Mortgage-backed Securities | | Municipal Securities | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Amount | Yield | Amount | Yield | | | Amount | Yield |
| Within one year | $ 1,000 | 4.75% | $ - | 0.00% | $ - | 0.00% | $ 1,000 | 4.75% |
| After one to five years | 19,000 | 4.95% | 1,060 | 3.56% | - | 0.00% | 20,060 | 4.88% |
| After five to ten years | - | 0.00% | 5,021 | 4.74% | 440 | 3.60% | 5,461 | 4.65% |
| After ten years | - | 0.00% | 47,295 | 5.04% | 15,391 | 4.19% | 62,686 | 4.83% |
| Total | $ 20,000 | 4.94% | $ 53,376 | 4.98% | $ 15,831 | 4.17% | $ 89,207 | 4.83% |

The following table presents a maturity distribution at amortized cost for securities held to maturity and the weighted average yield for each type and range of maturity as of December 31, 2007:

| (in thousands) | Government Sponsored Enterprises | | Mortgage-backed Securities | | Other Debt Securities | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| Within one year | $ 2,000 | 3.25% | $ - | -% | $ 11 | 7.75% | $ 2,011 | 3.27% |
| After one to five years | - | 0.00% | 196 | 4.12% | - | -% | 196 | 4.12% |
| After five to ten years | - | -% | - | 0.00% | - | -% | - | 0.00% |
| After ten years | - | -% | 1,543 | 4.46% | 3,523 | 4.84% | 5,066 | 4.72% |
| Total | $ 2,000 | 3.25% | $ 1,739 | 4.42% | $ 3,534 | 4.85% | $ 7,273 | 4.30% |

As the decline in fair value is attributed to changes in the interest rates and not credit quality, the Bank does not consider any of its securities to be other-than-temporarily impaired at December 31, 2007 because we have the ability and intent to hold securities with unrealized losses until a market price recovery (which may be until maturity.)

## Deposits

Customer deposits, consisting of savings and money market accounts, time deposits, and retail and commercial checking accounts, represent the primary source of asset funding for the Bank. The Bank’s customer deposits increased by $67.7 million or 23.4 percent to $356.4 million at December 31, 2007 from the December 31, 2006 level of $288.8 million. Certificates of deposit (“CD”), a higher cost source of funds, comprised 56.4 percent of total deposits December 31, 2007 compared to 59.3 percent at December 31, 2006.

| (in thousands) | December 31, 2007 | 2006 |
|---|---|---|
| Noninterest-bearing demand | **$ 37,343** | $ 28,999 |
| Interest-bearing: | | |
| NOW accounts | **56,638** | 37,322 |
| Regular savings | **32,098** | 28,402 |
| IRA savings | **4,954** | 4,437 |
| Mortgage escrow savings | **1,583** | 1,254 |
| Money market savings | **22,368** | 16,749 |
| Club accounts | **316** | 291 |
| Certificates of deposit | **201,124** | 171,318 |
| Total interest-bearing | **319,081** | 259,773 |
| | **$ 356,424** | $ 288,772 |

The increase in total deposits resulted from an increase in Certificates of Deposit of $29.8 million, an increase in NOW accounts of $19.3 million, an increase of $5.6 million in money market accounts, as well as an increase of $4.5 million in savings accounts. Substantially all of the Bank's deposits are considered by management to be core deposits, and as a matter of policy, the Bank does not utilize brokers to solicit deposits.

During 2007, the Bank acquired in a business combination $78.0 million of deposits. These deposits consisted of $43.8 million of certificates of deposit and $34.2 million of savings and demand deposits.

## Borrowings

Total borrowings, comprised primarily of term advances and securities sold under repurchase agreements from the Federal Home Loan Bank of New York ("FHLB"), decreased by $3.1 million to $52.8 million at December 31, 2007. FHLB advances increased by $2.0 million to $22.5 million at December 31, 2007. Securities sold under agreements to repurchase with the FHLB were $30.0 million at December 31, 2007 and $35.0 million at December 31, 2006.

## Capital Resources

The Bank exceeds all minimum regulatory capital requirements. Total shareholders' equity at December 31, 2007 was $41.0 million, an increase of $16.4 million from December 31, 2006. The increase resulted from net income of $2.1 million and a decrease of $.4 million in accumulated other comprehensive loss, the issuance of $5.9 and $9.7 million in common and preferred stock, respectively, which was partially offset by the purchase of $.6 million in treasury shares, and by cash dividends on common stock and preferred stock of $1.4 million.

During the fourth quarter of 2007 the Bank conducted a private placement of 287,376 shares of restricted common stock. The shares were placed with 75 accredited investors at a price of $21.00 per share. The net proceeds from the issuance were $5.9 million. This stock was issued to provide capital for the fourth quarter 2007 business combination. The shares are restricted from sale for six months. Also during the fourth quarter of 2007, the Bank issued 10,000 shares of perpetual, noncumulative, preferred stock with a liquidation value of $1,000. These shares were placed with one shareholder. The shares have a coupon rate of 8.998% for the first ten years and float at 4.00% above LIBOR thereafter. The shares are redeemable at the Bank's option with penalty beginning in 2013. The preferred shares have preference in respect to dividends.

No common or preferred shares were issued to Bank directors or Bank officers.

At December 31, 2007, there were 1,736,350 shares of common stock outstanding. Book value per share was $18.04 at December 31, 2007. The Bank's cash dividends paid per common share during 2007 was $.83. The Bank has paid regular cash dividends on its common stock since the first quarter of 1988 and intends to continue the practice of regular cash dividend payments on its common stock as long as it remains profitable and is in compliance with regulatory capital requirements. On June 22, 2007 the Bank distributed a 10% stock dividend totaling 131,770 shares.

Capital adequacy in the banking industry is evaluated primarily by the use of ratios that measure capital and capital components against total assets, as well as against assets that are weighted based on risk characteristics. At December 31, 2007 and 2006, the Bank exceeded its minimum regulatory capital requirements. At December 31, 2007 and 2006, the Bank's consolidated core (Tier 1) capital ratios were 6.30 percent and 6.75 percent, respectively. At December 31, 2007 and 2006, the Bank's consolidated risk-based capital ratios were 10.56 percent and 11.42 percent, respectively.

## RESULTS OF OPERATIONS

### Earnings Summary

The Bank's net income for 2007 was $2.1 million compared with net income for 2006 of $1.7 million, an increase of $.4 million or 23.7 percent. Net income for 2005 was $2.8 million. Diluted earnings per share were $1.33, $1.15, and $1.89 for the years 2007, 2006, and 2005, respectively.

### Net Interest Income

Net interest income is the principal component of net income for the Bank and represents the difference between the interest earned on assets, primarily loans and securities, and the interest paid on deposits and borrowed funds. There are two ratios the Bank uses to evaluate net interest income. They are interest rate spread and net interest margin. Interest rate spread is the difference between the average yield earned on interest-earning assets and the average rate paid on interest-bearing liabilities. Net interest margin is the measure of net interest income as a percentage of average interest-earning assets. Unlike net interest spread, the net interest margin takes into account the level of average earning assets that are funded by interest-free sources, such as noninterest-bearing demand deposits.

Net interest income increased by $694,000 (7.0 percent) to $10.6 million in 2007. The Bank's interest rate spread for 2007 was 2.44 percent, a decrease of 23 basis points from 2006. The Bank's net interest margin decreased by 17 basis points to 2.84 percent in 2007 from 3.01 percent in 2006.

Total average interest-earning assets increased by $44.1 million to $371.7 million in 2007, an increase of 13.5 percent. The average yield on total interest-earning assets increased to 6.11 percent in 2007 from 5.81 percent in 2006.

Total average loans increased by $34.8 million to $247.8 million. The average yield on loans increased by 14 basis points from 6.51 percent in 2006 to 6.65 percent in 2007. Total average residential real estate loans, which represents the greatest proportion of total loans, increased

by $14.8 million to $117.2 million. The average rate earned on these loans increased to 6.07 percent in 2007 from 6.04 percent in 2006, an increase of 3 basis points.

Total average securities, including short-term investments, increased by $9.3 million to $124.0 million. The average yield on securities increased from 4.50 percent in 2006 to 5.05 percent in 2007.

Compared to 2005 results, net interest income decreased by $397,000 (3.9 percent) to $9.9 million in 2006. The Bank's net interest spread was 2.67 percent in 2006, a decrease of 44 basis points from 2005. The Bank's net interest margin decreased by 36 basis points from 3.37 percent in 2005 to 3.01 percent in 2006.

The following table sets forth, for the periods indicated, summary information regarding: (i) the dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) the dollar amount of interest expense on interest-bearing liabilities and the resultant average costs; (iii) net interest income; (iv) interest rate spread; and (v) net interest margin. Average balances are daily averages. No tax equivalent adjustments were made. Nonaccrual loans are included in average loans.

| | **2007** | | | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|---|---|---|
| (dollars in thousands) | **Average Balance** | **Interest** | **Yield/Rate** | Average Balance | Interest | Yield/Rate | Average Balance | Interest | Yield/Rate |
| **Assets:** | | | | | | | | | |
| Loans | **$ 247,757** | **$ 16,466** | **6.65 %** | $ 212,978 | $ 13,869 | 6.51 % | $ 199,814 | $ 12,430 | 6.22 % |
| Short-term investments | **3,759** | **173** | **4.60** | 2,714 | 120 | 4.42 | - | - | - |
| Securities | **120,200** | **6,090** | **5.07** | 111,935 | 5,037 | 4.50 | 104,048 | 4,387 | 4.22 |
| Total interest-earning assets | **371,715** | **22,729** | **6.11** | 327,627 | 19,026 | 5.81 | 303,862 | 16,817 | 5.53 |
| Noninterest-earning assets | **19,597** | | | 18,218 | | | 18,354 | | |
| Total assets | **$ 391,312** | | | $ 345,845 | | | $ 322,216 | | |
| **Liabilities and shareholders' equity:** | | | | | | | | | |
| Interest-bearing deposits | **$ 261,574** | **9,087** | **3.47** | $ 227,259 | 6,545 | 2.88 | $ 215,506 | 4,554 | 2.11 |
| Borrowings | **70,037** | **3,090** | **4.41** | 64,876 | 2,623 | 4.04 | 54,873 | 2,008 | 3.66 |
| Total interest-bearing liabilities | **331,611** | **12,177** | **3.67** | 292,135 | 9,168 | 3.14 | 270,379 | 6,562 | 2.43 |
| Noninterest-bearing liabilities | **33,009** | | | 30,383 | | | 29,503 | | |
| Shareholders' equity | **26,692** | | | 23,200 | | | 22,334 | | |
| Total liabilities and shareholders' equity | **$ 391,312** | | | $ 345,718 | | | $ 322,216 | | |
| Net interest income | | **$ 10,552** | | | $ 9,858 | | | $ 10,255 | |
| Interest rate spread | | | **2.44 %** | | | 2.67 % | | | 3.11 % |
| Net interest margin | | | **2.84 %** | | | 3.01 % | | | 3.37 % |

The following table presents certain information regarding changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to: (i) changes in volume (i.e., changes in volume multiplied by prior year rate); (ii) changes in rate (i.e., changes in rate multiplied by prior year volume); and (iii) changes in rate/volume (i.e., change in rate multiplied by change in volume), which cannot be segregated and have been allocated proportionately to the changes due to volume and to the changes due to rate:

| (in thousands) | 2007 Compared to 2006 Increase (Decrease) Due to Volume | Rate | Total Increase (Decrease) | 2006 Compared to 2005 Increase (Decrease) Due to Volume | Rate | Total Increase (Decrease) |
|---|---|---|---|---|---|---|
| **Interest income:** | | | | | | |
| Loans | **$ 2,375** | **$ 222** | **2,597** | $ 1,067 | 372 | 1,439 |
| Short-term investments | **51** | **2** | **53** | - | 120 | 120 |
| Securities | **411** | **642** | **1,053** | 69 | 581 | 650 |
| Total interest income | **$ 2,837** | **866** | **3,703** | $ 1,136 | 1,073 | 2,209 |
| **Interest expense:** | | | | | | |
| Deposits | **1,633** | **909** | **2,542** | 804 | 1,187 | 1,991 |
| Borrowings | **284** | **183** | **467** | 506 | 109 | 615 |
| Total interest expense | **1,917** | **1,092** | **3,009** | 1,310 | 1,296 | 2,606 |
| Net interest income | **$ 920** | **(226)** | **694** | $ (174) | (223) | (397) |

The weighted average cost of total interest-bearing liabilities, which is comprised of deposits and borrowings, increased to 3.67 percent in 2007 as compared with the 2006 average cost of 3.14 percent. The cost of certificates of deposit increased by 58 basis points from 4.06 percent in 2006 to 4.64 percent in 2007. The increase in the 2007 cost of certificates of deposits was affected by a special 2006 certificate of deposit promotion during which the Bank raised approximately $60 million of new money at an annual percentage yield of 6.0%. The Bank experienced an increase in average borrowed funds of $5.2 million from 2006. The cost of these funds increased from 4.04 percent in 2006 to 4.41 percent in 2007.

The daily average balance, average cost, and interest expense for the Bank's deposit categories is summarized below:

| (dollars in thousands) | 2007 Average Balance | Average Cost | Interest Expense | 2006 Average Balance | Average Cost | Interest Expense |
|---|---|---|---|---|---|---|
| Noninterest-bearing | $30,838 | -% | $ - | $28,763 | -% | $ - |
| NOW accounts | 40,239 | 1.58% | 635 | 41,450 | 1.71% | 710 |
| Savings accounts | 52,418 | 1.17% | 614 | 54,007 | 0.90% | 484 |
| Time deposits | 168,916 | 4.64% | 7,838 | 131,802 | 4.06% | 5,351 |
| Total deposits | $292,411 | 3.11% | $ 9,087 | $256,022 | 2.56% | $ 6,545 |

| | 2005 Average Balance | Average Cost | Interest Expense |
|---|---|---|---|
| Noninterest-bearing | $27,173 | -% | $ - |
| NOW accounts | 47,422 | 1.79% | 848 |
| Savings accounts | 65,799 | 0.82% | 542 |
| Time deposits | 102,285 | 3.09% | 3,164 |
| Total deposits | $242,679 | 1.88% | $4,554 |

Maturities of time certificates of deposit of $100,000 or more outstanding at December 31, 2007 are summarized as follows:

| (in thousands) | |
|---|---|
| 3 months or less | $ 6,170 |
| over 3 through 6 months | 24,821 |
| over 6 through 12 months | 19,638 |
| over 12 months | 9,497 |
| | $ 60,126 |

The following table presents the interest expense on the Bank's borrowings for the years ended December 31:

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| | (dollars in thousands) | | |
| Repurchase agreements | $ 1,568 | $ 1,436 | $ 857 |
| FHLB term advances | 1,497 | 1,158 | 1,118 |
| Notes payable | 25 | 29 | 33 |
| Total borrowings | $ 3,090 | $ 2,623 | $ 2,008 |

Managing and maintaining net interest income and net interest margin is a primary focus for the Bank and is a key determinant in the maintenance and improvement of overall earnings. Management will focus on generating growth in core retail and commercial deposits through its existing market and branch network. To the extent possible, within acceptable levels of risk, the Bank intends to manage its asset and liability mix to optimize the level of its net interest margin.

## Provision for (Credit) Loan Losses

Management maintains an allowance for loan losses at a level considered adequate to provide for the estimated inherent risk of loss in the current loan portfolio based upon its quarterly analysis. Management uses the results of the analysis in determining the amount of the quarterly provision (credit) for loan losses that it considers necessary to maintain the allowance for loan losses at an adequate level. Based on this analysis, the provision (credit) for loan losses amounted to $525,000, ($290,000), and $155,000 in 2007, 2006, and 2005, respectively.

The increase in nonaccrual loans from $.1 million at December 31, 2006 to $2.2 million at December 31, 2007, combined with the loan growth and increases in delinquencies, resulted in the Bank's increased provision for loan losses.

The provision for loan losses was reduced in 2006 due to the reduction in classified and nonperforming loans as well as the continued positive trend in loan chargeoffs. Specifically, during 2006 the Bank received a $2.6 million paydown on a $2.7 million commercial credit that had been classified substandard.

## Noninterest Income

Total noninterest income for 2007 was $2.6 million, an increase of $1.6 million or 152.6 percent over noninterest income for 2006. During 2007 the Bank sold its FDIC credit and recorded a gain of $185,000, experienced an increase of $89,000 in service fees, a $116,000 increase in other income, and recorded $210,000 of gain on sale of securities. As discussed above, during 2006 the Bank recognized a $916,000 loss on sale of securities. During 2005, the Bank recognized a $633,000 gain on the elimination of its post-retirement benefit plan.

## Noninterest Expense

Total noninterest expense for 2007 amounted to $9.8 million, $8.9 million, and $8.5 million in 2007, 2006, and 2005, respectively. The $9.8 million of noninterest expense for 2007 represents an increase of $936,000 from 2006 levels. Salaries and benefits increased $693,000 or a 15.6 percent increase from the 2006 expense of $4.4 million. The increase in salaries and benefits is attributable to an increase in salaries due to a full year of operation of our Corning office combined with the partial year's expense from the four recently acquired branches. Additionally, the Bank experienced an increase in its health care costs for its employees. Marketing and public relations expense increased by $127,000, professional fees increased by $61,000, and data processing expense increased by $68,000.

## Income Taxes

The Bank's income tax expense amounted to $.7 million, $.6 million, and $1.4 million in 2007, 2006, and 2005, respectively. Effective tax rates for these periods were 24.8 percent, 26.3 percent, and 32.7 percent, respectively. The reduction in the effective tax rate experienced in 2007 was primarily due to the increased proportional level of tax exempt income (primarily from tax exempt municipal bonds and Bank-Owned Life Insurance) to income before income taxes. The increase in income tax expense was due to the increase in income before taxes to $2.8 million in 2007 from $2.3 million in 2006.

## Comparison of 2006 and 2005 Operating Results

The Bank's net income for 2006 was $1.7 million compared with net income for 2005 of $2.8 million, a decrease of $1,088,000 or 39.1 percent.

## Net Interest Income

Net interest income decreased by $397,000 (3.9 percent) to $9.9 million in 2006. The Bank's interest rate spread for 2006 was 2.67 percent, a decrease of 44 basis points from 2005. The Bank's net interest margin decreased by 36 basis points to 3.01 percent in 2006 from 3.37 percent in 2005.

## Provision (Credit) for Loan Losses

The credit for loan losses amounted to $290,000 in 2006 and a provision of $155,000 in 2005. The provision for loan losses was reduced as a result of a $2.6 million paydown on a $2.7 million commercial real estate credit that had been classified substandard. This paydown, along with the reduction in nonperforming loans and the continued positive trend in loan chargeoffs, resulted in the Bank's credit for loan losses.

## Noninterest Income

Total noninterest income for 2006 was $1.0 million, a decrease of $1,569,000 or 60.8 percent over noninterest income for 2005. During 2006, the Bank recognized a $916,000 loss on the sale of securities, while during 2005 the Bank recognized a $633,000 gain on the elimination of its post-retirement benefit plan.

## Noninterest Expense

Total noninterest expense for 2006 amounted to $8.9 million, an increase of $315,000 from 2005 levels. Salaries and benefits increased $149,000 or 3.5 percent increase from the 2005 expense of $4.3 million.

## Income Taxes

The Bank's income tax expense amounted to $.6 million in 2006 and $1.4 million in 2005. Effective tax rates for these periods were 26.3 percent and 32.7 percent. The improvement in the effective tax rate experienced in 2006 and 2005 was due primarily to the benefit of tax deferred investing in Bank-Owned Life Insurance and tax exempt municipal bonds.

## Recently Issued Accounting Standards

In September 2006, the FASB released SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. This standard applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The Bank adopted this statement on January 1, 2008 and does not expect adoption to have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," including an amendment of FASB Statement No. 115. SFAS No. 159 allows entities to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities that are not otherwise required to be measured at fair value, with changes in fair value recognized in earnings as they occur. SFAS No. 159 also requires entities to report those financial assets and financial liabilities measured at fair value in a manner that separates those reported fair values from the carrying amounts of similar assets and liabilities measured using another measurement attribute on the face of the statement of financial condition. Lastly, SFAS No. 159 establishes presentation and disclosure requirements designed to improve comparability between entities that elect different measurement attributes for similar assets and liabilities. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Bank adopted this statement on January 1, 2008 and does not expect adoption to have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations (revised – 2007)." SFAS No. 141(R) is a revision to previously existing guidance on accounting for business combinations. The statement retains the fundamental concept of the purchase method of accounting and introduces new requirements for the recognition and measurement of assets acquired, liabilities assumed, and noncontrolling interests. The Bank is required to adopt this statement on January 1, 2009 and does not expect adoption to have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements." SFAS No. 160 requires that noncontrolling interests be reported as stockholders equity and establishes a single method of accounting for changes in a parent's

ownership interest in a subsidiary as long as that ownership change does not result in deconsolidation. The Bank is required to adopt this statement for its fiscal year beginning after December 15, 2008. The Bank plans to adopt this statement on January 1, 2009 and does not expect adoption to have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

## Item 7A – Quantitative and Qualitative Disclosures about Market Risk

## Asset/Liability Management

The Bank, like other financial institutions, is subject to interest rate risk to the extent that its interest-bearing liabilities reprice on a different basis or at different time periods from its interest-earning assets. The scheduled maturities of the Bank's fixed rate interest-earning assets are generally longer than the maturities of the Bank's fixed rate interest-bearing liabilities. Therefore, interest rate risk is the most significant market risk affecting the Bank. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Bank's business activities.

During 1993, the Bank's primary regulator, the Office of Thrift Supervision (OTS) adopted new methods of measuring the interest rate sensitivity of thrifts it supervises. This method estimates the Net Portfolio Value (NPV) of the Bank's assets and liabilities, given different increases and decreases in interest rates. However, due to the historically low interest environment we are currently experiencing, the OTS has supplied data for the 200 basis point increase in rates and a 100 basis point decrease in rates. The Bank's NPV, given shocks of -100, +200 and 0 basis points as of December 31, 2007, is shown in the table below.

### Interest Rate Sensitivity of Net Portfolio Value (NPV)

| | -100bp | 0bp | +200bp |
|---|---|---|---|
| | | (dollars in thousands) | |
| Assets | $461,081 | $454,930 | $437,645 |
| Liabilities | 418,369 | 414,552 | 407,412 |
| Off-balance sheet positions | 83 | 46 | (131) |
| Net portfolio value | $42,796 | $40,423 | $30,102 |
| NPV as a percentage of the present value of assets | 9.28% | 8.89% | 6.88% |
| Change in the NPV ratio | 0.40% | - | (2.01%) |

Generally, a bank with an increased NPV under decreased interest rates would have higher net interest income in times of decreasing market interest rates and lower net interest income in times of increasing market interest rates. Therefore, a primary objective of the Bank's policies is to manage interest rate risk over time in order to optimize net interest income in changing interest rate environments without incurring imprudent interest rate sensitivity risks. The Bank's strategies are intended to be responsive to changes in interest rates and to prudently accommodate customer demands for particular types of deposit and loan products. As of December 31, 2007, the OTS classified the Bank's interest rate sensitivity risk as moderate.

The following table sets forth scheduled contractual maturities of the Bank's commercial real estate and commercial loans as of December 31, 2007. Based on experience with such loans, partial or full repayment of a portion of the Bank's commercial real estate loans and commercial loans prior to contractual maturity can be expected.

| (in thousands) | Within one year | One to four years | Over four years | Total |
|---|---|---|---|---|
| Commercial real estate | $ 18,524 | $ 31,735 | $ 8,938 | $ 59,197 |
| Commercial loans | 26,255 | 15,436 | 8,151 | 49,842 |
| Total | $ 44,779 | $ 47,171 | $ 17,089 | $ 109,039 |

Of the loan amounts shown above maturing over one year, $45.0 million have adjustable rates and $19.3 million have fixed rates.

## Liquidity

Liquidity refers to the availability of funds to meet deposit withdrawals, fund loan commitments, and pay expenses. Proper liquidity management provides the necessary access to funds to satisfy these requirements. Failure to manage liquidity properly can result in the necessity to fund these obligations on less than desirable terms. The Bank monitors the level of short-term assets and liabilities, maintaining an appropriate balance between liquidity, risk, and return.

The Bank's primary sources of cash and cash equivalents are interest and other revenue, loan payments, and securities portfolio maturities, or sales. Cash and cash equivalents are also provided by new deposits and borrowings. If the Bank requires funds beyond its ability to generate them internally, borrowing arrangements with the Federal Home Loan Bank provide an additional source of funds.

The Bank's Consolidated Statements of Cash Flows presented in the Consolidated Financial Statements included with this Annual Report identify cash flows from operating, investing, and financial activities. During 2007, $4.0 million was provided by operating activities, $6.0 million was provided by investing activities, and $259,000 was provided by financing activities. Accordingly, cash and cash equivalents increased by $10.3 million to $30.0 million at December 31, 2007.

Management monitors the Bank's liquidity position on a regular basis as part of the asset/liability and funds management process and anticipates that sufficient funds were available to meet current loan commitments and any unanticipated outflow of deposits. At December 31, 2007, outstanding loan commitments amounted to $8.8 million. Time certificates of deposit scheduled to mature in one year or less at December 31, 2007 totaled $153.1 million. Based on historic retention rates, management believes that a significant portion of these deposits will remain with the Bank.

We are contractually obligated to make payments as follows (dollars in thousands):

| (dollars in thousands) | Total | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
|---|---|---|---|---|---|
| Total Borrowings | $ 52,776 | $ 6,050 | $ 10,593 | $ 17,100 | $ 19,033 |
| Operating Leases | 1,486 | 279 | 540 | 417 | 250 |
| Total Obligations | $ 54,262 | $ 6,329 | $ 11,133 | $ 17,517 | $ 19,283 |

## Impact of Inflation

The Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles with regard to measurement of financial position and operating results in terms of historic dollars without consideration of the change in purchasing power of money over time due to inflation. Essentially, all of the Bank's assets and liabilities are monetary in nature. Consequently, interest rates have a more significant impact on a financial institution's performance than does inflation. The primary impact of inflation on operations of the Bank is increased operating expenses.

# Item 8 – Financial Statements and Supplementary Data

***The Elmira Savings Bank, FSB and Subsidiaries***

**Consolidated Balance Sheets**

| (in thousands, except for share and per share amounts) | December 31, 2007 | December 31, 2006 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | **$ 17,958** | $ 19,632 |
| Federal funds sold and other short-term investments | **12,000** | - |
| **Total cash and equivalents** | **29,958** | 19,632 |
| | | |
| Securities available for sale, at fair value | **88,670** | 91,846 |
| Securities held to maturity, fair value of $7,256 at December 31, 2007 and $7,850 at December 31, 2006 | **7,273** | 7,959 |
| Federal Home Loan Bank stock, at cost | **2,748** | 2,903 |
| | | |
| Loans held for sale | **95** | - |
| | | |
| Loans receivable, net | **299,887** | 226,381 |
| Less: Allowance for loan losses | **2,478** | 1,665 |
| | | |
| **Net loans** | **297,409** | 224,716 |
| | | |
| Premises and equipment, net | **6,165** | 5,442 |
| Bank-owned life insurance | **4,150** | 3,984 |
| Accrued interest receivable | **2,103** | 1,753 |
| Intangible assets, net | **1,306** | 241 |
| Goodwill | **12,295** | - |
| Other real estate owned | **7** | 178 |
| Due from brokers for security sales | **-** | 11,000 |
| Other assets | **1,508** | 1,766 |
| | | |
| **Total assets** | **$ 453,687** | $ 371,420 |
| | | |
| **Liabilities and Shareholders' Equity** | | |
| Deposits | **$ 356,424** | $ 288,772 |
| Borrowings | **52,776** | 55,846 |
| Other liabilities | **3,468** | 2,168 |
| | | |
| **Total liabilities** | **412,668** | 346,786 |
| | | |
| Shareholders' equity: | | |
| Preferred stock, $1,000 liquidation value per share; authorized 10,000 shares; 10,000 shares issued at December 31, 2007 | **9,700** | - |
| Common stock, $1 par value; authorized 5,000,000 shares; 1,869,350 shares issued at December 31, 2007; and 1,443,022 shares at December 31, 2006 | **1,869** | 1,443 |
| Additional paid-in capital | **34,075** | 25,000 |
| Retained (deficit) earnings | **(545)** | 2,049 |
| Treasury stock, at cost - 133,000 shares at December 31, 2007 and 112,647 at December 31, 2006 | **(3,751)** | (3,145) |
| Accumulated other comprehensive loss, net of taxes | **(329)** | (713) |
| | | |
| **Total shareholders' equity** | **41,019** | 24,634 |
| | | |
| **Total liabilities and shareholders' equity** | **$ 453,687** | $ 371,420 |

See accompanying notes to consolidated financial statements.

*The Elmira Savings Bank, FSB and Subsidiaries*

**Consolidated Statements of Income**

| (in thousands, except for per share amounts) | Years ended December 31, 2007 | 2006 | 2005 |
|---|---|---|---|
| Interest and dividend income: | | | |
| Interest and fees on loans | **$ 16,466** | $ 13,869 | $ 12,430 |
| Interest and dividends on securities | | | |
| Taxable | **5,439** | 4,550 | 4,092 |
| Non-taxable | **824** | 607 | 295 |
| **Total interest and dividend income** | **22,729** | 19,026 | 16,817 |
| Interest expense: | | | |
| Interest on deposits | **9,087** | 6,545 | 4,554 |
| Interest on borrowings | **3,090** | 2,623 | 2,008 |
| **Total interest expense** | **12,177** | 9,168 | 6,562 |
| Net interest income | **10,552** | 9,858 | 10,255 |
| Provision (credit) for loan losses | **525** | (290) | 155 |
| **Net interest income after provision (credit )for loan losses** | **10,027** | 10,148 | 10,100 |
| Noninterest income: | | | |
| Service fees | **1,329** | 1,240 | 1,210 |
| Gain on sale of loans held for sale | **53** | 95 | 182 |
| Gain on sale of FDIC net assessment credits | **185** | - | - |
| Net gain (loss) on sale of securities | **210** | (916) | 31 |
| Other service fees | **471** | 412 | 368 |
| Bank-owned life insurance | **167** | 154 | 150 |
| Gain on elimination of Post Retirement Benefit Plan | **-** | - | 633 |
| Other | **144** | 28 | 8 |
| **Total noninterest income** | **2,559** | 1,013 | 2,582 |
| Noninterest expense: | | | |
| Salaries and benefits | **5,137** | 4,444 | 4,295 |
| Net occupancy | **870** | 796 | 810 |
| Equipment | **822** | 856 | 813 |
| Marketing and public relations | **571** | 444 | 487 |
| Professional fees | **549** | 488 | 525 |
| Data Processing | **438** | 370 | 346 |
| Directors fees | **205** | 184 | 178 |
| Printing and supplies | **203** | 172 | 154 |
| Telephone | **161** | 148 | 155 |
| Postage | **125** | 122 | 118 |
| Regulatory assessments | **127** | 114 | 113 |
| Amortization of intangible assets | **127** | 107 | 107 |
| Other | **464** | 618 | 447 |
| **Total noninterest expense** | **9,799** | 8,863 | 8,548 |
| **Income before income taxes** | **2,787** | 2,298 | 4,134 |
| Income taxes | **692** | 604 | 1,352 |
| **Net income** | **$ 2,095** | $ 1,694 | $ 2,782 |
| Basic earnings per share | **$ 1.34** | $ 1.16 | $ 1.91 |
| Diluted earnings per share | **$ 1.33** | $ 1.15 | $ 1.89 |

Per share data has been restated to reflect a 10% stock dividend paid on June 22, 2007.

See accompanying notes to consolidated financial statements.

***The Elmira Savings Bank, FSB and Subsidiaries***

**Consolidated Statements of Shareholders' Equity**

| (in thousands, except for share and per share amounts) | Years ended December 31, 2007, 2006, and 2005<br>Preferred stock | Common stock | Additional paid-in capital | Retained (deficit) earnings | Treasury stock | Accumulated other comprehensive loss | Total |
|---|---|---|---|---|---|---|---|
| **Balance at December 31, 2004** | **$ -** | **1,204** | **18,542** | **5,958** | **(2,985)** | **(444)** | **22,275** |
| Comprehensive Income: | | | | | | | |
| Change in net unrealized loss on securities available for sale, net of taxes of ($705) | | - | - | - | - | (1,227) | (1,227) |
| Net Income | | - | - | 2,782 | - | - | 2,782 |
| Total Comprehensive Income | | | | | | | 1,555 |
| 10% Stock dividend (109,327 shares) | | 109 | 3,006 | (3,115) | - | - | - |
| Exercise of stock options, net (3,438 shares) | | 4 | 27 | - | - | - | 31 |
| Cash in lieu of fractional shares resulting from a 10% stock dividend | | - | - | (4) | - | - | (4) |
| Purchase of Treasury Stock (5,000 shares) | | - | - | - | (160) | - | (160) |
| Cash dividends ($.62 per share) | | - | - | (912) | - | - | (912) |
| **Balance at December 31, 2005** | **$ -** | **1,317** | **21,575** | **4,709** | **(3,145)** | **(1,671)** | **22,785** |
| Comprehensive Income: | | | | | | | |
| Change in net unrealized loss on securities available for sale, net of taxes of $551 | | - | - | - | - | 958 | 958 |
| Net Income | | - | - | 1,694 | - | - | 1,694 |
| Total Comprehensive Income | | | | | | | 2,652 |
| 10% Stock dividend (120,185 shares) | | 120 | 3,179 | (3,299) | - | - | - |
| Stock based compensation expense | | | 122 | | | | 122 |
| Exercise of stock options, net (6,164 shares) | | 6 | 124 | - | - | - | 130 |
| Cash in lieu of fractional shares resulting from a 10% stock dividend | | - | - | (6) | - | - | (6) |
| Cash dividends ($.72 per share) | | - | - | (1,049) | - | - | (1,049) |
| **Balance at December 31, 2006** | **$ -** | **1,443** | **25,000** | **2,049** | **(3,145)** | **(713)** | **24,634** |
| Comprehensive Income: | | | | | | | |
| Change in net unrealized loss on securities available for sale, net of taxes of $202 | - | - | - | - | - | 384 | 384 |
| Net Income | - | - | - | 2,095 | - | - | 2,095 |
| Total Comprehensive Income | | | | | | | 2,479 |
| 10% Stock dividend (131,770 shares) | - | 132 | 3,163 | (3,295) | - | - | - |
| Stock based compensation expense | - | - | 161 | | | | 161 |
| Exercise of stock options, net (7,182 shares) | - | 7 | 119 | - | - | - | 126 |
| Common Stock Issued (287,376 shares) | - | 287 | 5,632 | - | - | - | 5,919 |
| Preferred Stock Issued (10,000 shares) | 9,700 | - | - | - | - | - | 9,700 |
| Cash in lieu of fractional shares resulting from a 10% stock dividend | - | - | - | (4) | - | - | (4) |
| Purchase of Treasury Stock (20,353 shares) | - | - | - | - | (606) | - | (606) |
| Cash dividend on preferred stock | - | - | - | (110) | - | - | (110) |
| Cash dividend on common stock ($.83 per share) | | - | - | (1,280) | - | - | (1,280) |
| **Balance at December 31, 2007** | **9,700** | **$ 1,869** | **34,075** | **(545)** | **(3,751)** | **(329)** | **41,019** |

Per share data has been restated to reflect a 10% stock dividend paid on June 22, 2007.
See accompanying notes to consolidated financial statements.

***The Elmira Savings Bank, FSB and Subsidiaries - Consolidated Statements of Cash Flows***

| (in thousands) | Years ended December 31, 2007 | 2006 | 2005 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net income | **$ 2,095** | $ 1,694 | $ 2,782 |
| Adjustments to reconcile net income to net cash provided by operating activities | | | |
| Depreciation and amortization of premises and equipment | **555** | 618 | 666 |
| Change in net deferred loan origination costs | **(233)** | (74) | (57) |
| Amortization of intangible assets | **127** | 107 | 107 |
| Deferred income taxes | **(104)** | 81 | 128 |
| Provision (credit) for loan losses | **525** | (290) | 155 |
| Net amortization of premiums and discounts | **130** | 232 | 329 |
| Net (gains) loss on security transactions | **(210)** | 916 | (31) |
| Net gains on sales of other real estate owned | **(62)** | (13) | (80) |
| Gains on sale of loans held for sale | **(54)** | (95) | (182) |
| Proceeds from sale of held for sale | **1,242** | 4,697 | 9,536 |
| Originations of loans held for sale | **(1,283)** | (4,602) | (9,354) |
| Income from Bank-owned life insurance | **(167)** | (154) | (150) |
| Stock based compensation | **161** | 122 | - |
| Changes in certain assets and liabilities affecting operations: | | | |
| Accrued interest receivable | **(167)** | (246) | (176) |
| Other assets | **177** | (655) | 1,159 |
| Other liabilities | **1,300** | (738) | (447) |
| **Net cash provided by operating activities** | **4,032** | 1,600 | 4,385 |
| **Cash flows from investing activities:** | | | |
| Proceeds from sales of securities available for sale | **44,851** | 22,357 | 3,864 |
| Proceeds from maturities of and principal collected on securities available for sale | **34,172** | 10,658 | 17,045 |
| Proceeds from maturities of and principal collected on securities held to maturity | **642** | 462 | 777 |
| Redemptions (Purchases) of FHLB stock | **155** | 471 | (997) |
| Purchases of securities available for sale | **(64,052)** | (39,832) | (27,226) |
| Purchases of securities held to maturity | **(84)** | (70) | (56) |
| Purchases of Bank-owned life insurance | **-** | - | (1,400) |
| Purchases of premises and equipment, net | **(216)** | (322) | (273) |
| Proceeds from sales of other real estate owned | **240** | 53 | 222 |
| Proceeds from acquisition of branches | **28,041** | - | - |
| Net increase in loans receivable | **(37,714)** | (20,194) | (9,027) |
| **Net cash provided by (used in) investing activities** | **6,035** | (26,417) | (17,071) |
| **Cash flows from financing activities:** | | | |
| (Decrease) increase in time deposits | **(14,050)** | 61,759 | (19,062) |
| Increase (decrease) in other deposits | **3,634** | (14,706) | 12,218 |
| Advances from FHLB term advances | **11,000** | 20,000 | 35,000 |
| Repayment of FHLB term advances | **(9,017)** | (38,017) | (27,815) |
| Proceeds from securities sold under repurchase agreements | **2,000** | 20,000 | 16,000 |
| Repayment of securities sold under repurchase agreements | **(7,000)** | (12,000) | (2,000) |
| Repayment of notes payable | **(53)** | (49) | (46) |
| Proceeds from the issuance of common stock | **5,919** | - | - |
| Proceeds from the issuance of preferred stock | **9,700** | - | - |
| Purchase of treasury stock | **(606)** | - | (160) |
| Cash dividends on common stock | **(1,280)** | (1,049) | (912) |
| Cash dividends on preferred stock | **(110)** | - | - |
| Payment of cash in lieu of fractional shares resulting from stock dividend | **(4)** | (6) | (4) |
| Tax benefit of stock options exercised | **17** | 60 | - |
| Stock options exercised | **109** | 70 | 31 |
| **Net cash provided by financing activities** | **259** | 36,062 | 13,250 |
| **Net increase in cash and cash equivalents** | **10,326** | 11,245 | 564 |
| Cash and cash equivalents, beginning of year | **19,632** | 8,387 | 7,823 |
| **Cash and cash equivalents, end of year** | **$ 29,958** | $ 19,632 | $ 8,387 |
| **Supplemental disclosure of cash flow information:** | | | |
| Cash paid during the year for: | | | |
| Interest | **12,166** | 9,166 | 6,544 |
| Income taxes | **493** | 986 | 213 |
| Schedule of noncash investing activities: | | | |
| Other real estate acquired in settlement of loans | **$ 7** | $ 218 | $ 213 |
| Sale of securities not settled | **(11,000)** | 11,000 | - |
| Fair value of non-cash assets acquired in purchase acquisition | **50,027** | - | - |
| Fair value of liabilities assumed in purchase acquisition | **78,068** | - | - |

See accompanying notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## *NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*

### GENERAL

The Elmira Savings Bank, FSB and Subsidiaries (the "Bank") provide financial services to consumers and businesses within the Bank's geographic market area. That area includes Chemung, Steuben, Schuyler and Tompkins Counties and surrounding areas in New York State, and Tioga and Bradford Counties in Pennsylvania. The Bank provides traditional banking services to its customers.

The Bank is subject to regulation and periodic examination by certain regulatory agencies.

### BASIS OF PRESENTATION

The consolidated financial statements include the accounts of The Elmira Savings Bank, FSB and its wholly-owned subsidiaries, ESB Advisory Services, Inc. and ESB Realty Corp. Inter-company transactions and balances have been eliminated in consolidation.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reporting practices followed by the banking industry. Whenever necessary, prior year amounts are reclassified to conform to current year presentation. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and revenues and expenses for the reporting period. Significant items subject to such estimates and assumptions include the allowance for loans losses, valuation of deferred income tax assets, mortgage servicing rights, and intangible assets. Actual results could differ from those estimates.

### CASH AND CASH EQUIVALENTS

For purposes of reporting cash flows in the consolidated statements of cash flows, cash and cash equivalents include cash on hand and amount due from banks, as well as federal funds sold and other short-term investments with maturities of three months or less at time of purchase.

### SECURITIES

The Bank classifies its debt securities as either available for sale or held to maturity at the time of purchase, as the Bank does not hold any securities considered to be trading. Held to maturity securities are those debt securities that the Bank has the ability and intent to hold until maturity. All other debt securities are classified as available for sale.

Available for sale securities are recorded at fair value. Held to maturity securities are recorded at amortized cost. Unrealized holding gains and losses, net of the related tax effect on available for sale securities, are excluded from earnings and are reported as accumulated other comprehensive income (loss) in shareholders'

equity until realized. A decline in the fair value of any security below cost, that is deemed other than temporary, is charged to earnings, resulting in the establishment of a new cost basis for the security.

Premiums and discounts are amortized or accreted over the life of the related debt security as an adjustment of yield using the interest method. Dividend and interest income are recognized when earned. Purchases and sales are recorded on a trade date basis with settlement occurring shortly thereafter. Realized gains and losses on securities sold are determined using the specific identification method.

## LOANS

Loans receivable are carried at unpaid principal balances, net of deferred fees and costs. Interest on loans receivable is accrued as earned. Loan origination fees and certain direct loan origination costs are deferred and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the related loans.

Loans, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-collateralized and in the process of collection. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms of the loan.

While a loan is classified as nonaccrual and the future collectibility of the recorded loan balance is uncertain, any payments received are generally used to reduce the principal balance. When the future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged-off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Interest collections in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

The Bank sells certain residential real estate loans in the secondary market. The Bank may retain the right to service the loan, or may sell the loan servicing released. The Bank determines whether a loan will be held for sale at the time the application is received from the customer. Loans held for sale are carried at the lower of aggregate cost or estimated fair value. Gains and losses on the disposition of loans held for sale are determined on the specific identification method.

The Bank typically retains the servicing rights to mortgage loans sold and recognizes as separate assets, included in other assets, the rights to service

loans for others. Mortgage servicing rights are amortized in proportion to, and over the period of, estimated net servicing income. Additionally, mortgage servicing rights are assessed for impairment based on the fair value of those rights, and any impairment is recognized through a valuation allowance by a charge to income.

## ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained at a level which management believes, to the best of its knowledge, is at a level at each reporting date to cover known and inherent losses in the loan portfolio that are both probable and reasonably estimable. Management's evaluation is based upon a continuing review of the loan portfolio, which includes many factors such as identification of adverse situations affecting the borrower's ability to repay, a review of overall portfolio quality, including the level of nonperforming and delinquent loans, historical loss experience, and an assessment of prevailing economic conditions.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in general economic conditions and the overall financial health of the Bank's market area. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgment of information available to them at the time of their examination.

Commercial related loans are considered impaired when it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Residential mortgage loans, consumer loans, home equity lines of credit and education loans are evaluated collectively since they are homogeneous and generally carry smaller individual balances. In addition, loans restructured in a troubled debt restructuring are also considered impaired loans.

The Bank estimates impairment based on the present value of expected future cash flows (discounted at the loan's effective interest rate) or the fair value of the underlying collateral, less estimated costs to sell, if the loan is collateral dependent. The Bank's impaired loans are generally collateral dependent. An impairment loss exists if the recorded investment in a loan exceeds the value of the loan as measured by the aforementioned methods. Impairment losses are recognized as a component of the allowance for loan losses.

## PREMISES AND EQUIPMENT

Land is carried at cost while buildings, leasehold improvements and furniture, fixtures and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, with buildings being thirty-nine years and furniture, fixtures and equipment generally being five years. Leasehold improvements are amortized over the lesser of the estimated useful life or the term of the leases. Maintenance and repairs are charged to expense and improvements are capitalized.

## BANK-OWNED LIFE INSURANCE

Bank-owned life insurance is carried at the cash surrender value of the underlying policies. Income on the investments in the policies, net of insurance costs, is recorded as noninterest income.

## OTHER REAL ESTATE OWNED

Real estate acquired in settlement of loans is recorded at the lower of cost, defined as the fair value at the time of initial foreclosure, or the fair value of the real estate less estimated costs to sell. Write-downs from the recorded investment in the loan to fair value, less estimated costs to sell, at the time of foreclosure are charged to the allowance for loan losses. Subsequent write-downs to fair value, less estimated costs to sell, are charged to other expenses. Operating costs associated with the properties are charged to expense as incurred.

## GOODWILL

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not being amortized, but is required to be tested for impairment annually or more often if certain conditions or events occur.

## INTANGIBLE ASSETS

Intangible assets, net of accumulated amortization, consist of core deposit intangibles. The core deposit intangible from the 1999 branch acquisition is being amortized over ten years on a straight-line basis. The core deposit intangible from the 2007 business combination is being amortized over ten years on an accelerated basis.

## IMPAIRMENT OF LONG-LIVED ASSETS OTHER THAN GOODWILL

The Bank reviews long-lived assets, including premises and equipment, for impairment whenever events or changes in business circumstances indicate that the remaining useful life may warrant revision or that the carrying amount of the long-lived asset may not be fully recoverable. The Bank performs undiscounted cash flow analyses to determine if impairment exists. If impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.

## MORTGAGE SERVICING RIGHTS

Capitalized mortgage servicing rights are recognized based on their fair value, included in other assets, and are amortized as an offset to loan servicing income over the period of estimated net servicing income. Mortgage servicing rights are assessed for impairment based on the fair value of those rights. Prepayment experience on mortgage servicing rights is reviewed periodically and, when actual payments exceed estimated prepayments, the balance of the mortgage servicing assets is reduced by a charge to earnings.

## INCOME TAXES

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to “temporary differences” between the financial statement carrying

amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using currently enacted tax rates applicable to the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change in rates is enacted. The Bank recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense.

The Bank adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109,* (FIN 48) on January 1, 2007. Since the Bank did not have any significant unrecognized tax benefits, there was no effect on its financial condition or results of operations as a result of implementing FIN 48. As of the date of adoption of FIN 48, the Bank did not have any accrued interest or penalties associated with any unrecognized tax benefits.

## PREFERRED STOCK

During 2007, the Bank authorized and issued 10,000 shares of preferred stock. Proceeds from the sale of preferred stock were $10.0 million, reduced by $300,000 of issuance costs for net proceeds of $9.7 million. The preferred stock has a liquidation preference of $1,000 per share. Dividends are paid quarterly in cash at a rate of 8.998% of the liquidation preference through December 2017; thereafter, dividends will be paid at LIBOR plus 4.0%. The preferred stock is redeemable at the Bank's option beginning on November 16, 2012.

## EARNINGS PER SHARE

Basic earnings per share excludes dilution and is calculated by dividing net income available to common shareholders (net income less preferred stock dividends) by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity, such as the Bank's stock options.

All earnings per share data and other per share amounts in the consolidated financial statements have been restated to give retroactive effect to stock dividends.

## STOCK-BASED COMPENSATION PLANS

The Bank adopted Statement of Financial Accounting Standards (SFAS) No. 123 (Revised), "Share-Based Payment" ("SFAS No. 123(R)") on January 1, 2006, using the modified prospective method. Under this method, compensation costs recognized beginning in 2006 includes: (a) the compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based upon the grant date fair value estimated in accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," and (b) the compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). Compensation cost is recorded on a straight-line basis over the vesting period of the awards. Results from prior periods have not

been restated. Prior to adoption of SFAS No. 123(R) on January 1, 2006, the Bank applied Accounting Principles Board Opinion (APB Opinion) No. 25, "Accounting for Stock Issued to Employees," ("APB No. 25") and related interpretations in accounting for its stock option plan. Under APB No. 25, compensation expense was recognized only if the exercise price of the option is less than the trading value of the underlying stock at the grant date.

The following table illustrates the effects on net income and earnings per share if the Bank had applied the fair value recognition provisions of SFAS No. 123(R) to all outstanding and unvested awards in 2005:

| | 2005 |
|---|---|
| Net Income: | $2,782 |
| As Reported | |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | 109 |
| Pro forma | $2,673 |
| Basic earning per share: | |
| As Reported | $1.91 |
| Pro forma | $1.83 |
| Diluted earnings per share: | |
| As Reported | $1.89 |
| Pro forma | $1.82 |

## COMPREHENSIVE INCOME

Comprehensive income at the Bank represents net income plus or minus other comprehensive income or loss, which consists of the net change in unrealized gains and losses on securities available for sale, net of taxes, and is presented in the Consolidated Statements of Shareholders' Equity.

## SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Bank enters into sales of U.S. Government sponsored enterprises and mortgage-backed securities under agreements to repurchase ("repurchase agreements"). These repurchase agreements are treated as financings, and the obligations to repurchase securities sold are reflected as liabilities in the Consolidated Balance Sheets. The amount of the securities underlying the repurchase agreements remains an asset on the Bank's Consolidated Balance Sheet. The securities underlying the repurchase agreements remain under the Bank's control.

## TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets, typically residential real estate loans for the Bank, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

## SEGMENT INFORMATION

Substantially all of the Bank's operations involve the delivery of loan and deposit products to customers in its primary geographical market. Management makes operating decisions and assesses performance on an entity-wide basis. Therefore, the Bank has only one operating segment for financial reporting.

## FINANCIAL INSTRUMENTS WITH OFF BALANCE SHEET RISK AND CONCENTRATION OF CREDIT RISK

The Bank is a party to certain financial instruments with off-balance sheet risk such as loan commitments, commercial lines of credit, home equity lines of credit, and standby letters of credit. The Bank's policy is to record such instruments when funded. Those instruments involve, to varying degrees, elements of credit and market risk in excess of the amount recognized in the consolidated balance sheet. Credit risk represents the accounting loss that would be recognized at the reporting date if counter-parties failed completely to perform as contracted. Unless noted otherwise, the Bank does not require collateral or other security to support off-balance sheet financial instruments with credit risk. Market risk represents the risk that future changes in market prices may make a financial instrument less valuable.

The Bank considers its primary market area for lending and savings activities to be Chemung, Tompkins, Steuben, Cayuga, and Schuyler Counties in New York and Tioga and Bradford Counties in Pennsylvania. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is reliant upon the economic stability of the area. Other than general economic risks, there is no material concentration of credit risk to any industry or individual borrower.

## RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the FASB released SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. This standard applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The Bank adopted this statement on January 1, 2008 and does not expect adoption to have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," including an amendment of FASB Statement No. 115. SFAS No. 159 allows entities to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities that are not otherwise required to be measured at fair value, with changes in fair value recognized in earnings as they occur. SFAS No. 159 also requires entities to report those financial assets and financial liabilities measured at fair value in a manner that separates those reported fair values from the carrying amounts of similar assets and liabilities measured using another measurement attribute on the face of the statement of financial condition.

Lastly, SFAS No. 159 establishes presentation and disclosure requirements designed to improve comparability between entities that elect different measurement attributes for similar assets and liabilities. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Bank adopted this statement on January 1, 2008 and does not expect adoption to have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

## *NOTE 2* *RESERVE REQUIREMENTS*

The Bank is required to maintain certain reserves of cash and/or deposits with the Federal Reserve Bank. The amount of this reserve requirement, which was covered by the Bank's vault cash included in cash and due from banks, was approximately $425,000 and $333,000 at December 31, 2007 and 2006, respectively.

## *NOTE 3* *EARNINGS PER SHARE*

The following sets forth certain information regarding the calculation of basic and diluted earnings per share ("EPS") for the years ended December 31:

| (in thousands, except share and per share amounts) | **2007** | 2006 | 2005 |
|---|---|---|---|
| Net income | **$ 2,095** | $ 1,694 | $ 2,782 |
| Dividend on Preferred Stock | **110** | | |
| | **$ 1,985** | **$ 1,694** | **$ 2,782** |
| Weighted average common shares outstanding | **1,478,594** | 1,457,084 | 1,458,054 |
| Dilutive effect of potential common shares related to stock based compensation plans | **9,295** | 11,281 | 11,070 |
| Weighted average common shares including potential dilution | **1,487,889** | 1,468,365 | 1,469,124 |
| Basic earnings per share | **$ 1.34** | $ 1.16 | $ 1.91 |
| Diluted earnings per share | **$ 1.33** | $ 1.15 | $ 1.89 |

There were 61,859 and 41,161 antidilutive options for 2007 and 2006, respectively. There were no antidilutive options for 2005.

## *NOTE 4* *OTHER COMPREHENSIVE INCOME (LOSS)*

The following summarizes the components of other comprehensive income, which relate to available for sale securities, for the years ended December 31, 2007, 2006, and 2005:

| (in thousands) | **2007** | 2006 | 2005 |
|---|---|---|---|
| Other comprehensive income (loss), before tax: | | | |
| Net unrealized holding gain (loss) on securities arising during the year | **$ 796** | $ 593 | $ (1,901) |
| Reclassification adjustment for realized net (gains) losses included in net income | **(210)** | 916 | (31) |
| Other comprehensive income (loss), before tax | **586** | 1,509 | (1,932) |
| Income tax (expense) benefit related to items of other comprehensive income (loss) | **(202)** | (551) | 705 |
| Other comprehensive income (loss), net of tax | **$ 384** | $ 958 | $ (1,227) |

## *NOTE 5* *SECURITIES*

Securities available for sale are summarized as follows:

| (in thousands) | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
|---|---|---|---|---|
| **December 31, 2007:** | | | | |
| U.S. Government sponsored enterprises | $ 20,000 | - | (42) | 19,958 |
| Mortgage-backed securities | 53,376 | 231 | (475) | 53,132 |
| Municipal securities | 15,831 | 12 | (263) | 15,580 |
| | **$ 89,207** | **243** | **(780)** | **88,670** |
| **December 31, 2006:** | | | | |
| U.S. Government sponsored enterprises | $ 38,000 | 2 | (188) | 37,814 |
| Mortgage-backed securities | 40,415 | 20 | (999) | 39,436 |
| Municipal securities | 14,554 | 54 | (12) | 14,596 |
| | **$ 92,969** | **76** | **(1,199)** | **91,846** |

Securities held to maturity are summarized as follows:

| (in thousands) | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
|---|---|---|---|---|
| **December 31, 2007:** | | | | |
| U.S. Government sponsored enterprises | $ 2,000 | - | (8) | 1,992 |
| Mortgage-backed securities | 1,739 | 3 | (28) | 1,714 |
| Municipal securities | 3,166 | 16 | - | 3,182 |
| Other debt securities | 368 | - | - | 368 |
| | **7,273** | **19** | **(36)** | **7,256** |
| **December 31, 2006:** | | | | |
| U.S. Government sponsored enterprises | $ 2,000 | - | (42) | 1,958 |
| Mortgage-backed securities | 2,364 | 2 | (69) | 2,297 |
| Municipal securities | 3,283 | - | - | 3,283 |
| Other debt securities | 312 | - | - | 312 |
| | **7,959** | **2** | **(111)** | **7,850** |

U.S. government sponsored enterprises securities represent debt securities issued by agencies of the United States government such as FNMA, Freddie Mac, or FHLB. Mortgage-backed securities are all direct pass through securities guaranteed by FNMA, FHLMC, or GNMA.

The contractual maturity distribution of debt securities at December 31, 2007 is shown in the following table. Maturities of mortgage-backed securities are classified in accordance with the contractual repayment schedules. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Securities available for sale | | Securities held to maturity | |
|---|---|---|---|---|
| (in thousands) | Amortized cost | Fair value | Amortized cost | Fair value |
| Due in one year or less | $ 1,000 | 998 | $ 2,011 | $ 2,003 |
| Due after one year through five years | 20,060 | 19,999 | 196 | 194 |
| Due after five years through ten years | 5,461 | 5,474 | - | - |
| Due after ten years | 62,686 | 62,199 | 5,066 | 5,059 |
| | **$ 89,207** | **88,670** | **$ 7,273** | **$ 7,256** |

At December 31, 2007 and 2006, U. S. Government sponsored enterprises and mortgage-backed securities of approximately $1.6 million and $2.2 million, respectively, have been pledged as collateral for certain deposit relationships and $33.4 million and $41.2 million respectively, has been pledged as collateral for repurchase agreements.

The following table summarizes the Bank's investment securities both available for sale and held to maturity where the current fair value is less than the related amortized cost.

| (in thousands) | Less than 12 months Fair value | Unrealized Losses | 12 months or longer Fair value | Unrealized Losses | Total Fair value | Unrealized Losses |
|---|---|---|---|---|---|---|
| **December31, 2007:** | | | | | | |
| U.S. Government sponsored enterprises | $ 10,980 | (20) | $ 6,969 | $ (31) | $ 17,949 | $ (51) |
| Mortgage-backed securities | 360 | - | 26,682 | (504) | 27,042 | (504) |
| Municipal securities | 13,657 | (262) | - | - | 13,657 | (262) |
| | **$ 24,997** | **(282)** | **$ 33,651** | **$ (535)** | **$ 58,648** | **$ (817)** |
| **December31, 2006:** | | | | | | |
| U.S. Government sponsored enterprises | $ 11,989 | (11) | $ 15,781 | $ (219) | $ 27,770 | $ (230) |
| Mortgage-backed securities | 4,690 | (18) | 44,981 | (1,050) | 49,671 | (1,068) |
| Municipal securities | 1,082 | (8) | 436 | (4) | 1,518 | (12) |
| | **$ 17,761** | **(37)** | **$ 61,198** | **$ (1,273)** | **$ 78,959** | **$ (1,310)** |

The above table represents 105 and 86 investment securities at December 31, 2007 and 2006, respectively, both available for sale and held to maturity, where the current fair value is less than the related amortized cost. These unrealized losses do not reflect any deterioration of the credit worthiness of the issuing entities. No security has a current rating that is below investment grade. The unrealized losses on these temporarily impaired securities are a result of changes in interest rates where the interest rate received is less than the current rate available for new offerings of similar securities, changes in market spreads as a result of shifts in supply and demand, and changes in the level of prepayments for mortgage-related securities. Because the decline in fair value is attributed to changes in interest rates and not credit quality, and because the Bank has the intent and ability to hold these securities until a market price recovery or maturity, these securities are not considered other than temporarily impaired.

Gross realized gains and losses from sales of securities available for sale are:

| (in thousands) | Gross realized gains | Gross realized losses |
|---|---|---|
| **Year ended December 31,** | | |
| **2007** | **$ 210** | **$ -** |
| 2006 | 26 | 942 |
| 2005 | 31 | - |

## *NOTE 6 FEDERAL HOME LOAN BANK STOCK*

As a member of the Federal Home Loan Bank (FHLB), the Bank is required to invest in $100 par value stock of the FHLB. When such stock is redeemed, the Bank would receive from the FHLB an amount equal to the par value of the stock. At December 31, 2007 and 2006, FHLB stock outstanding was $2.7 million and $2.9 million, respectively.

## *NOTE 7 LOANS*

Loans consisted of the following:

| | December 31, | |
|---|---|---|
| (in thousands) | **2007** | **2006** |
| **Real estate loans:** | | |
| Residential | **$ 130,409** | $ 106,162 |
| Commercial | **59,197** | 38,656 |
| Construction | **3,019** | 1,529 |
| | **192,625** | 146,347 |
| **Business loans:** | | |
| Commercial loans | **49,842** | 35,556 |
| | **49,842** | 35,556 |
| **Consumer loans:** | | |
| Installment loans | **46,253** | 37,158 |
| Home equity loans | **9,271** | 6,294 |
| Other loans | **1,383** | 746 |
| | **56,907** | 44,198 |
| **Loans receivable** | **299,374** | 226,101 |
| Net deferred origination fees and costs | **513** | 280 |
| **Loans receivable, net** | **299,887** | 226,381 |
| Allowance for loan losses | **2,478** | 1,665 |
| **Net Loans** | **$ 297,409** | $ 224,716 |

Mortgage loans serviced by the Bank for others, which are not included in the consolidated financial statements, were $64.5 million and $70.0 million at December 31, 2007 and 2006, respectively. At December 31, 2007 the Bank had $95,000 of loans held for sale. The Bank did not have any loans held for sale at December 31, 2006.

The following summarizes the activity in the allowance for loan losses:

| | Years ended December 31, | | |
|---|---|---|---|
| (in thousands) | **2007** | 2006 | 2005 |
| Balance at beginning of year | **$ 1,665** | $ 2,095 | $ 1,965 |
| Provision (credit) for loan losses | **525** | (290) | 155 |
| Allowance acquired in business combination | **521** | - | - |
| Charge-offs | **(289)** | (284) | (302) |
| Recoveries | **56** | 144 | 277 |
| **Balance at end of year** | **$ 2,478** | $ 1,665 | $ 2,095 |

At December 31, 2007, the recorded investment in loans that are considered to be impaired totaled $1.9 million. Included in impaired loans at December 31, 2007 are $1.7 million of loans that had a related allowance for loan losses due to the adequacy of collateral or previous charge-offs taken. At December 31, 2006 there were no loans that were considered impaired.

The average recorded investment in impaired loans during the years ended December 31, 2007, 2006, and 2005 was $238,000, $130,000 and $265,000, respectively. There was no interest income recognized on impaired loans in 2007, 2006, and 2005.

The principal balances of loans not accruing interest, including the impaired loans described above, amounted to approximately $2.2 million, $110,000 and $659,000 at December 31, 2007, 2006 and 2005, respectively. Interest income

that would have been recorded had these loans not been placed on nonaccruing status was $83,000 in 2007, $8,000 in 2006, and $19,000 in 2005.

Loan transactions with directors and officers were made on the same terms as those prevailing at the same time for comparable loans to other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. An analysis of related party loan activity follows:

| | Years ended December 31, | |
|---|---|---|
| (in thousands) | **2007** | 2006 |
| Balance at beginning of year | **$ 6,014** | $ 6,267 |
| Advances | **2,295** | 986 |
| Repayments | **(767)** | (1,239) |
| Balance at end of year | **$ 7,542** | $ 6,014 |

## NOTE 8 PREMISES AND EQUIPMENT

Premises and equipment, net, are summarized as follows:

| | December 31, | |
|---|---|---|
| (in thousands) | **2007** | 2006 |
| Land and land improvements | **$ 1,218** | $ 1,178 |
| Building and leasehold improvements | **6,978** | 6,051 |
| Furniture, fixtures and equipment | **5,191** | 4,918 |
| | **13,387** | 12,147 |
| Accumulated depreciation and amortization | **7,222** | 6,705 |
| | **$ 6,165** | $ 5,442 |

Depreciation and amortization expense amounted to $555,000, $618,000 and $666,000 for the years ended December 31, 2007, 2006, and 2005, respectively.

## NOTE 9 ACCRUED INTEREST RECEIVABLE

Accrued interest receivable consisted of the following:

| | December 31, | |
|---|---|---|
| (in thousands) | **2007** | 2006 |
| Accrued interest receivable on securities | **$ 822** | $ 853 |
| Accrued interest receivable on loans | **1,281** | 900 |
| | **$ 2,103** | $ 1,753 |

## NOTE 10 ACQUISITION, GOODWILL, AND OTHER INTANGIBLE ASSETS

On December 3, 2007, the Bank completed the acquisition of four branches in the counties of Tompkins and Cayuga. This acquisition was accounted for as a business combination in accordance with Statement of Financial Accounting Standards No. 141 (“SFAS No. 141”). As a result of this acquisition, the Bank received $28.0 million related to the net liabilities assumed in the acquisition. The results of operation of the acquired branches are included in the Bank’s consolidated financial statements from the date of acquisition. The identified intangible asset from this acquisition is a core deposit intangible of $1.2 million which is being amortized over ten years on an accelerated basis. Goodwill resulting from the acquisition was $12.3 million. The fair value of assets acquired and liabilities assumed in the acquisition are as follows:

| (in thousands) | | Fair Value |
|---|---|---|
| Loans | $ | 35,278 |
| Cash | | 28,041 |
| Goodwill | | 12,295 |
| Core Deposit intangible | | 1,192 |
| Premises and equipment | | 1,062 |
| Accrued interest receivable and other assets | | 200 |
| Total Assets | $ | 78,068 |
| Certificates of Deposits | $ | 43,856 |
| Other Deposits | | 34,212 |
| Total Liabilities | $ | 78,068 |

Prior to 2007, the Bank's intangible assets consisted of a core deposit intangible related to a prior branch acquisition that is being amortized over ten years on a straight-line basis.

Information regarding the carrying amount and the amortization expense of the Bank's acquired intangible assets is disclosed in the tables below:

| December 31, 2007 (in thousands) | | Gross Carrying Amount | | Accumulated Amortization | | Net Carrying Amount |
|---|---|---|---|---|---|---|
| Amortized intangible assets - Core Deposit Intangible | $ | 2,264 | $ | 958 | $ | 1,306 |
| Goodwill | | 12,295 | | - | | 12,295 |
| Total goodwill and amortized intangible assets | $ | 14,559 | $ | 958 | $ | 13,601 |

| December 31, 2006 (in thousands) | | Gross Carrying Amount | | Accumulated Amortization | | Net Carrying Amount |
|---|---|---|---|---|---|---|
| Amortized intangible assets - Core Deposit Intangible | $ | 1,072 | $ | 831 | $ | 241 |

Amortization expense related to core deposit intangibles totaled $127,000 in 2007 and $107,000 in 2006 and 2005. The estimated aggregate future amortization expense for intangible assets remaining as of December 31, 2007 is as follows:

| Estimated amortization expense: (in thousands) | | |
|---|---|---|
| For the year ended December 31, 2008 | $ | 320 |
| For the year ended December 31, 2009 | | 220 |
| For the year ended December 31, 2010 | | 172 |
| For the year ended December 31, 2011 | | 150 |
| For the year ended December 31, 2012 | | 128 |

## *NOTE 11 DEPOSITS*

A summary of deposits follows:

| | December 31, | | | |
|---|---|---|---|---|
| (in thousands) | | **2007** | | 2006 |
| Noninterest-bearing demand | **$** | **37,343** | $ | 28,999 |
| Interest-bearing: | | | | |
| NOW accounts | | **56,638** | | 37,322 |
| Regular savings | | **32,098** | | 28,402 |
| IRA savings | | **4,954** | | 4,437 |
| Mortgage escrow savings | | **1,583** | | 1,254 |
| Money market savings | | **22,368** | | 16,749 |
| Club accounts | | **316** | | 291 |
| Certificates of deposit | | **201,124** | | 171,318 |
| Total interest-bearing | | **319,081** | | 259,773 |
| | **$** | **356,424** | $ | 288,772 |

Individual time deposit accounts with balances of $100,000 or more, which are included in the above table, totaled approximately $60.1 million and $50.3 million at December 31, 2007 and 2006, respectively.

Contractual maturities of time certificates of deposit at December 31, 2007 are as follows:

| (in thousands) | |
|---|---|
| Maturity distribution | Amount |
| Due in one year | $ 153,120 |
| Due in one to two years | 28,183 |
| Due in two to three years | 9,777 |
| Due in three to four years | 5,593 |
| Due in four to five years | 4,419 |
| Due in five or more years | 32 |
| | $ 201,124 |

Interest expense on deposit accounts for 2007, 2006, and 2005 is as follows:

| (in thousands) | **2007** | 2006 | 2005 |
|---|---|---|---|
| Savings | **$ 270** | $ 226 | $ 219 |
| NOW | **635** | 710 | 848 |
| Money market | **344** | 258 | 323 |
| Certificates of deposit | **7,838** | 5,351 | 3,164 |
| Total interest on deposits | **$ 9,087** | $ 6,545 | $ 4,554 |

## *NOTE 12 BORROWINGS*

Borrowings consisted of the following:

| | December 31, | |
|---|---|---|
| (in thousands) | **2007** | 2006 |
| Securities sold under repurchase agreements | **$ 30,000** | $ 35,000 |
| Federal Home Loan Bank term advances | **22,493** | 20,512 |
| Note payable | **283** | 334 |
| | **$ 52,776** | $ 55,846 |

Information related to securities sold under repurchase agreements was as follows:

| | Years ended December 31, | | |
|---|---|---|---|
| (dollars in thousands) | **2007** | 2006 | 2005 |
| Outstanding balance at end of year | **$ 30,000** | $ 35,000 | $ 27,000 |
| Weighted average interest rate at end of year | **4.62%** | 4.48% | 4.00% |
| Maximum outstanding at any month end | **$ 37,000** | $ 43,000 | $ 27,000 |
| Average amount outstanding during year | **$ 34,397** | $ 33,132 | $ 20,370 |
| Average interest rate during year | **4.50%** | 4.28% | 4.15% |

The repurchase agreements, which are callable by the Federal Home Loan Bank, had stated final maturities that ranged from 2.7 years to 8.5 years at December 31, 2007, and 2.5 years to 9.6 years at December 31, 2006. U.S. Government sponsored enterprises and mortgage-backed securities with a fair value of $33.4 million and $41.0 million were pledged to secure the repurchase agreements at December 31, 2007 and 2006, respectively.

Scheduled contractual repayments for securities sold under repurchase agreements are as follows:

| (in thousands) | Amount |
|---|---|
| **Year** | |
| 2008 | $ - |
| 2009 | - |
| 2010 | **5,000** |
| 2011 | **6,000** |
| 2012 | **2,000** |
| Thereafter | **17,000** |
| | **$ 30,000** |

The $22.5 million and $20.5 million of Federal Home Loan Bank ("FHLB") term advances outstanding at December 31, 2007 and 2006, respectively, have rates that range between 2.76 percent and 6.28 percent. All term advances are collateralized by the Bank's investment in FHLB stock and all qualifying mortgage loans pursuant to provisions of a collateral pledge and securities agreement up to a maximum of $88.5 million. Included in the term advances at December 31, 2007 are $22.0 million of advances that are callable in the future by the FHLB. The Bank also has additional lines of credit for short-term borrowings available from the FHLB in the amount of $75.2 million.

Scheduled principal reductions for each of the next five years and thereafter for the term advances from the FHLB are as follows (based on contractual maturity dates):

| (in thousands) | Amount |
|---|---|
| **Year** | |
| 2008 | **$ 6,000** |
| 2009 | **4,493** |
| 2010 | **1,000** |
| 2011 | - |
| 2012 | **9,000** |
| Thereafter | **2,000** |
| | **$ 22,493** |

The note payable, which is collateralized by the Bank's main office building, requires payments of approximately $6,600 per month and bears an interest rate of 8.0 percent. The interest rate and monthly payment changed on April 1, 2007 and is not subject to change prior to maturity on April 1, 2012.

## *NOTE 13 COMMITMENTS AND CONTINGENCIES*

### Loan Commitments

Loan commitments are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Loan commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies, but may include real estate, accounts

receivable, inventory, property, plant and equipment, and income-producing commercial properties.

## Lease Agreements

The Bank is committed under four non-cancelable lease contracts for facilities, which expire between the years 2011 and 2017. The leases contain renewal provisions at the Bank's option and contain no restrictive provisions of consequence.

Expense for leased premises was $148,000, $128,000 and $106,000 for 2007, 2006, and 2005, respectively. Minimum annual lease payments at December 31, 2007 for the non-cancelable leases amounts to approximately $254,000 per year for years 2008 through 2010, $216,000 per year for 2011, and $194,000 per year for 2012.

## Other Commitments

In the normal course of business, various commitments and contingent liabilities are outstanding that are not reflected in the consolidated financial statements. Financial instruments with off-balance sheet risk involve elements of credit risk, interest rate risk, liquidity risk, and market risk. The Bank uses the same credit policy to make such commitments as is used for on-balance sheet items. Management does not anticipate any significant losses as a result of these transactions.

Commitments to originate mortgages and other loans were approximately $8.8 million and $8.7 million at December 31, 2007 and 2006, respectively. Approximately $6.2 million and $3.1 million of the commitments at December 31, 2007 and 2006, respectively, had fixed rates of interest. Commitments under commercial unused lines of credit were approximately $21.4 million and $13.9 million at December 31, 2007 and 2006, respectively. Commitments under unused overdraft honors lines of credit were approximately $5.5 million and $3.9 million at December 31, 2007 and 2006, respectively. Commitments under standby letters of credit were $650,000 and $358,000 at December 31, 2007 and 2006, respectively. The fair value of the Bank's standby letters of credit is not considered material for 2007 and 2006. Commitments for consumer lines of credit were approximately $13.9 million and $9.1 million at December 31, 2007 and 2006, respectively. Since some commitments to originate loans expire without being used and some unused lines of credit are never fully drawn upon, the amounts do not necessarily represent expected future cash outlays.

In order to reduce the interest rate risk associated with the portfolio of conventional mortgage loans held for sale, as well as outstanding loan commitments and uncommitted loan applications with rate lock agreements which are intended to be held for sale, the Bank enters into mandatory forward sales commitments to sell loans in the secondary market to unrelated investors. The impact of the estimated fair value of the rate lock agreements, offset by forward sales commitments, was not significant to the consolidated financial statements.

## Contingencies

In the normal course of business, there are various outstanding legal proceedings. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated financial condition of the Bank.

## *NOTE 14 INCOME TAXES*

Federal and state income tax expense (benefit) attributable to income before income taxes is as follows:

| | Years ended December 31, | | |
|---|---|---|---|
| (in thousands) | **2007** | 2006 | 2005 |
| **Current:** | | | |
| Federal | **$ 634** | $ 380 | $ 1,085 |
| State | **162** | 143 | 139 |
| | **796** | 523 | 1,224 |
| **Deferred:** | | | |
| Federal | **(29)** | 139 | 119 |
| State | **(75)** | (58) | 9 |
| | **(104)** | 81 | 128 |
| | **$ 692** | $ 604 | $ 1,352 |

The differences between income taxes computed by applying the U.S. Federal statutory tax rate to income before income taxes are as follows:

| | **Years ended December 31,** | | |
|---|---|---|---|
| (in thousands) | **2007** | 2006 | 2005 |
| Tax computed at statutory rate | **$ 947** | $ 781 | 1,405 |
| State tax provisions, net of Federal benefit | **58** | 56 | 98 |
| Tax exempt interest | **(337)** | (259) | (100) |
| Other items, net | **24** | 26 | (51) |
| | **$ 692** | $ 604 | 1,352 |

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2007 and 2006 follow:

| (in thousands) | **2007** | 2006 |
|---|---|---|
| **Assets:** | | |
| Deferred compensation | **$ 272** | $ 252 |
| Allowance for loan losses | **498** | 388 |
| Net unrealized loss on securities | **208** | 410 |
| Deferred expense | **35** | 61 |
| Mortgage recording tax | **160** | 111 |
| Amortization of intangible assets | **121** | 108 |
| Other | **70** | 44 |
| Deferred tax assets | **1,364** | 1,374 |
| | | |
| **Liabilities:** | | |
| Mortgage servicing rights | **142** | 155 |
| Deferred loan originations costs | **200** | 109 |
| Other | **31** | 21 |
| Deferred tax liabilities | **373** | 285 |
| Net deferred tax assets | **$ 991** | $ 1,089 |

Realization of deferred tax assets is dependent upon the generation of future taxable income or the existence of sufficient taxable income within the carryback

period. A valuation allowance is recognized when it is considered more likely than not that some portion of the deferred tax assets will not be realized. In assessing the need for a valuation allowance, management considers the scheduled reversal of the deferred tax liabilities, the level of historical taxable income, and projected future taxable income over the periods in which the temporary differences comprising the deferred tax assets will be deductible. Based on its assessment, management determined that no valuation allowance is necessary.

Due to the historical level of "qualifying assets" for tax purposes, the Bank has recognized deferred tax liabilities for its entire Federal and state bad debt reserves in accordance with SFAS No. 109.

The Bank is no longer subject to U.S. federal or state tax examinations for years before 2003.

## *NOTE 15 EMPLOYEE STOCK OWNERSHIP AND SAVINGS PLAN*

The Bank has an Employee Stock Ownership and Savings Plan ("the Plan"), which covers substantially all employees.

### 401(k) Savings Provisions:

The Plan allows employees to make 401(k) contributions. The Plan requires the Bank to contribute (match) an amount equal to the participants' 401(k) contributions, up to one-half of the first 6% of compensation deferred by each participant. Contributions made may be invested in fixed income securities, diversified mutual funds, or shares of the Bank's common stock. The Bank made 401(k) matching contributions of $80,200, $76,000, and $72,900 for the years ended December 31, 2007, 2006, and 2005, respectively.

### Employee Stock Ownership Provisions:

Contributions to the Plan are made in cash or common shares of the Bank and are one hundred percent vested. The Bank reports compensation expense equal to cash contributed and the current market price of any shares contributed. Compensation expense related to this plan in 2007, 2006, and 2005 was $150,000, $136,000, and $126,000, respectively.

## *NOTE 16 STOCK OPTION PLANS ("SOP")*

The Company's 1999 Stock Option Plan, as amended, (the "Stock Option Plan") authorizes the grant of options to purchase up to 188,100 shares of the Company's common stock. At December 31, 2007 there were 46,550 options available for grant. The Board of Directors of Elmira Savings Bank, FSB may grant stock options to officers, employees, and certain other qualified individuals. Stock options are granted at an exercise price equal to the stock's trading price at the date of grant, may not have a term in excess of ten years, and have vesting periods that range between zero and four years from the grant date. Prior to the adoption of the Stock Option Plan, the Company had similar stock option plans which remain in effect solely with respect to unexercised options issued under those plans.

The Company's practice is to issue original shares of its common stock upon exercise of stock options rather than treasury shares. The total intrinsic value (which is the amount by which the trading price of the underlying stock exceeds the exercise price of an option) of options exercised was $42,000 for 2007, and $118,000 for 2006. There was $109,000 of cash received from the exercise of stock options for 2007 and $70,000 for 2006.

The Company recognized total non-cash stock-based compensation cost of $161,000 and $122,000 for 2007 and 2006, respectively. As of December 31, 2007, the total remaining unrecognized compensation cost related to unvested stock options was $119,000. The unrecognized expense is expected to be recognized over the next 2.25 years. Forfeitures are not expected to be significant. The fair value of options vested was $146,000, $90,000, and $85,800 for 2007, 2006, and 2005, respectively.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model that uses the assumptions noted in the following table. Expected volatility is largely based on historical volatility of the Company's stock over a period that corresponds to the expected life of the options. Historical option exercise and employee termination activity is used to estimate the expected term of options granted and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The following table presents the weighted-average assumptions and resulting estimated weighted-average fair value for grants made during 2007, 2006, and 2005.

| | **2007** | 2006 | 2005 |
|---|---|---|---|
| **Dividend Yield** | 2.71% | 3.31% | 2.85% |
| **Volatility** | 26.67% | 26.95% | 22.10% |
| **Risk-free interest rate** | 4.55% | 4.50% | 4.50% |
| **Expectant life (years)** | 5 | 5 | 8.50 |
| **Fair Value** | 5.80 | 4.92 | 7.12 |

On the basis of these assumptions, the Bank has estimated that the fair value of the options granted in 2007, 2006, and 2005 were $5.80, $4.92, and $7.12, respectively.

A summary of the status of the Bank's stock option plans is presented below:

| | Number of Shares | Weighted-Average Exercise Price |
|---|---|---|
| Options: | | |
| Outstanding at December 31, 2004 | 58,571 | 14.81 |
| Granted | 29,430 | 23.62 |
| Exercised | (6,073) | 9.77 |
| Outstanding at December 31, 2005 | 81,928 | 18.09 |
| Granted | 32,250 | 22.19 |
| Exercised | (7,240) | 10.57 |
| Outstanding at December 31, 2006 | 106,938 | 19.84 |
| Granted | 15,250 | 24.55 |
| Exercised | (7,182) | 15.10 |
| Outstanding at December 31, 2007 | 115,006 | 21.04 |
| Total Exercisable at December 31, 2007 | 79,332 | 19.95 |

The following tables summarize the outstanding and exercisable options at December 31, 2007:

| **Options Outstanding** | | | **Options Excercisable** | |
|---|---|---|---|---|
| **Exercise Price** | **Number Outstanding** | **Weighted Average Contractual Life** | **Number Exercisable** | **Weighted Average Contractual Life** |
| $11.37 | 3,627 | 1.34 | 3,627 | 1.34 |
| $9.78 | 4,350 | 2.09 | 4,350 | 2.09 |
| $10.91 | 4,100 | 3.33 | 4,100 | 3.33 |
| $15.14 | 4,100 | 4.33 | 4,100 | 4.33 |
| $18.01 | 7,176 | 5.33 | 7,176 | 5.33 |
| $18.85 | 7,176 | 6.34 | 7,176 | 6.34 |
| $21.65 | 8,587 | 6.09 | 8,587 | 6.09 |
| $21.61 | 7,176 | 7.34 | 7,176 | 7.34 |
| $23.62 | 21,234 | 7.16 | 10,614 | 7.16 |
| $22.34 | 8,202 | 8.33 | 8,208 | 8.33 |
| $22.13 | 24,048 | 8.17 | 6,010 | 8.17 |
| $24.30 | 15,230 | 9.42 | 8,208 | 9.42 |
| | 115,006 | 6.91 | 79,332 | 5.87 |

The aggregate intrinsic value of total options outstanding at December 31, 2007 was $143,000. The aggregate intrinsic value of options exercisable at December 31, 2007 was $143,000.

## *NOTE 17 DISCLOSURES ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS*

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

### Cash and Cash Equivalents

The carrying amounts for cash and cash equivalents approximate the estimated fair value of such assets.

### Securities
Fair values of securities are based on quoted market prices, if available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. Fair value estimates for certain securities may be determined based upon pricing modeling techniques. Inputs to the pricing models may include recent trades, benchmark interest rates, spreads, and actual and projected cash flows. The carrying value of FHLB stock, which is redeemable at par, approximates fair value.

### Loans Receivable
For variable rate loans that reprice frequently and which entail no significant change in credit risk, fair values are based on the carrying values. The estimated fair values of certain mortgage loans may be based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics.

The estimated fair value of other loans is determined based on discounted cash flow analyses using interest rates currently offered for loans with similar terms to borrowers of similar credit quality. Fair value for impaired loans is estimated using discounted cash flow analyses or underlying collateral values, where applicable.

### Accrued Interest Receivable
The carrying amounts for accrued interest receivable approximate the estimated fair value of such assets.

### Deposits
The fair values estimated for noninterest-bearing demand deposits, NOW accounts, savings accounts, and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values of fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly time deposit maturities.

### Borrowed Funds
The carrying amount for securities sold under repurchase agreements approximates the estimated fair value of this liability.

The fair values of the FHLB advances and the note payable are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rate for similar borrowing arrangements.

### Off-Balance-Sheet Instruments
Fair values for the company's off-balance-sheet instruments (lines of credit and commitments to fund loans) are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

The estimated fair value of the Bank's financial instruments is as follows:

| (in thousands) | December 31, 2007 Carrying value | December 31, 2007 Fair value | December 31, 2006 Carrying value | December 31, 2006 Fair value |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Cash and Cash equivalents | $ 29,958 | $ 29,958 | $ 19,632 | $ 19,632 |
| Securities | 98,691 | 98,674 | 102,708 | 102,599 |
| Net loans | 297,409 | 300,959 | 224,716 | 220,289 |
| Accrued interest receivable | 2,103 | 2,103 | 1,753 | 1,753 |
| **Financial liabilities:** | | | | |
| Deposits | 356,424 | 360,666 | 288,772 | 289,712 |
| Borrowings | 52,776 | 52,468 | 55,846 | 49,674 |
| Accrued Interest Payable | 251 | 251 | 241 | 241 |

## *NOTE 18 MINIMUM CAPITAL AND OTHER REGULATORY REQUIREMENTS*

Office of Thrift Supervision ("OTS") capital regulations requires savings institutions to maintain minimum levels of regulatory capital. Under the regulations in effect at December 31, 2007, the Bank is required to maintain a minimum ratio of tangible capital to tangible assets of 1.5 percent; a minimum leverage ratio of core (Tier 1) capital to total adjusted tangible assets of 4.0 percent; and a minimum ratio of total capital (core capital and supplementary capital) to risk-weighted assets of 8.0 percent, of 4.0 percent must be core capital.

Under its prompt corrective action regulations, the OTS is required to take certain supervisory actions (and may take additional discretionary actions) with respect to an undercapitalized institution. Such actions could have a direct effect on an institution's financial statements. The regulations establish a framework for the classification of savings institutions into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Generally, an institution is considered well-capitalized if it has a core capital ratio of at least 5.0 percent; a core (Tier 1) risk-based capital ratio of at least 6.0 percent; and a risk-based capital ratio of at least 10.0 percent.

The following table is a reconciliation of the Bank's generally accepted accounting principles ("GAAP") capital and Regulatory capital at December 31, 2007 and December 31, 2006:

| (dollars in thousands) | GAAP Capital | OTS Capital Requirements<br>Tangible Capital | % | Core Capital | % | Total Risk-Based Capital | % |
|---|---|---|---|---|---|---|---|
| December 31, 2007 | $41,019 | $41,019 | | $41,019 | | $41,019 | |
| Regulatory capital adjustments | | | | | | | |
| Allowance for loan losses | | - | | - | | 2,478 | |
| Core deposit intangible | | (1,306) | | (1,306) | | (1,306) | |
| Goodwill | | (12,295) | | (12,295) | | (12,295) | |
| Net unrealized loss on securities available for sale | | 329 | | 329 | | 329 | |
| Total regulatory capital | | $27,747 | 6.30 | $27,747 | 6.30 | $30,225 | 10.56 |
| Regulatory capital requirement | | 6,606 | 1.50 | 17,617 | 4.00 | 22,902 | 8.00 |
| Regulatory capital excess | | **$21,141** | **4.80** | **$10,130** | **2.30** | **$7,323** | **2.56** |

| (dollars in thousands) | GAAP Capital | OTS Capital Requirements<br>Tangible Capital | % | Core Capital | % | Total Risk-Based Capital | % |
|---|---|---|---|---|---|---|---|
| December 31, 2006 | $24,634 | $24,634 | | $24,634 | | $24,634 | |
| Regulatory capital adjustments | | | | | | | |
| Allowance for loan losses | | - | | - | | 1,665 | |
| Core deposit intangible | | (241) | | (241) | | (241) | |
| Net unrealized loss on securities available for sale | | 713 | | 713 | | 713 | |
| Total regulatory capital | | $25,106 | 6.75 | $25,106 | 6.75 | $26,771 | 11.42 |
| Regulatory capital requirement | | 5,578 | 1.50 | 14,876 | 4.00 | 18,746 | 8.00 |
| Regulatory capital excess | | **$19,528** | **5.25** | **$10,230** | **2.75** | **$8,025** | **3.42** |

As of January 2006, the most recent notification from the OTS categorized the Bank as well-capitalized under the regulatory framework for prompt corrective actions. There have been no conditions or events since the notification that management believes have changed the Bank's category. Management believes that as of December 31, 2007, the Bank meets all capital adequacy requirements to which it is subject.

The following is a summary of the Bank's actual capital amounts and ratios as of December 31, 2007 and 2006, compared with the OTS requirements for minimum capital adequacy for classification of a well-capitalized institution:

| December 31,2007 | OTS Capital Requirements<br>Actual | | Minimum Capital Adequacy | | For Classification as Well-Capitalized | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Tangible capital | $27,747 | 6.30 | 6,606 | 1.50 | NA | NA |
| Core (Tier 1) capital | $27,747 | 6.30 | 17,617 | 4.00 | 22,021 | 5.00 |
| Risk-based capital: | | | | | | |
| Core (Tier 1) | 27,747 | 9.69 | 11,451 | 4.00 | 17,177 | 6.00 |
| Total risk-based capital | 30,225 | 10.56 | 22,902 | 8.00 | 28,628 | 10.00 |

| December 31,2006 | OTS Capital Requirements<br>Actual | | Minimum Capital Adequacy | | For Classification as Well-Capitalized | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Tangible capital | $25,106 | 6.75 | 5,578 | 1.50 | NA | NA |
| Core (Tier 1) capital | $25,106 | 6.75 | 14,876 | 4.00 | 18,595 | 5.00 |
| Risk-based capital: | | | | | | |
| Core (Tier 1) | 25,106 | 10.71 | 9,373 | 4.00 | 14,059 | 6.00 |
| Total risk-based capital | 26,771 | 11.42 | 18,746 | 8.00 | 23,432 | 10.00 |

The Bank is also subject to certain regulatory limitations on the amount that can be invested in consumer loans and non-mortgage commercial loans. The OTS limits the Bank's authority to invest in non-mortgage consumer loans and non-mortgage commercial loans to 35% and 10%, respectively, of total assets. At December 31, 2007 and December 31, 2006, the Bank was in compliance with these regulations.

The Bank may not declare or pay a cash dividend on, or repurchase any of its capital stock if the effect thereof would cause the capital of the Bank to be reduced below the amount required for the capital requirements imposed by the OTS.

## Summary of Quarterly Financial Results (Unaudited)

Summarized quarterly unaudited financial results for the years ended December 31, 2007 and 2006 are as follows:

| | 2007 | | | |
|---|---|---|---|---|
| (in thousands, except for per share amounts) | Quarter IV | Quarter III | Quarter II | Quarter I |
| Interest and dividend income | $ 5,904 | $ 5,848 | $ 5,582 | $ 5,395 |
| Interest expense | 3,119 | 3,171 | 3,005 | 2,882 |
| **Net interest income** | 2,785 | 2,677 | 2,577 | 2,513 |
| Provision for (recovery of) loan losses | 285 | 180 | 60 | - |
| **Net interest income after provision for loan losses** | 2,500 | 2,497 | 2,517 | 2,513 |
| Noninterest income | 773 | 744 | 537 | 505 |
| Noninterest expense | 3,184 | 2,260 | 2,209 | 2,146 |
| **Income before income taxes** | 89 | 981 | 845 | 872 |
| Income taxes | (58) | 274 | 234 | 242 |
| **Net income** | $ 147 | $ 707 | $ 611 | $ 630 |
| **Basic earnings per share** | $ 0.02 | $ 0.49 | $ 0.38 | $ 0.43 |
| **Diluted earnings per share** | $ 0.02 | $ 0.48 | $ 0.38 | $ 0.43 |

| | 2006 | | | |
|---|---|---|---|---|
| (in thousands, except for per share amounts) | Quarter IV | Quarter III | Quarter II | Quarter I |
| Interest and dividend income | $ 5,189 | $ 4,831 | $ 4,558 | $ 4,448 |
| Interest expense | 2,831 | 2,376 | 2,052 | 1,909 |
| **Net interest income** | 2,358 | 2,455 | 2,506 | 2,539 |
| Provision for (recovery of) loan losses | - | (225) | (95) | 30 |
| **Net interest income after provision for loan losses** | 2,358 | 2,680 | 2,601 | 2,509 |
| Noninterest income | (428) | 514 | 473 | 454 |
| Noninterest expense | 2,468 | 2,234 | 2,116 | 2,045 |
| **Income before income taxes** | (538) | 960 | 958 | 918 |
| Income taxes | (276) | 315 | 285 | 280 |
| **Net income** | $ (262) | $ 645 | $ 673 | $ 638 |
| **Basic earnings per share** | $ (0.18) | $ 0.45 | $ 0.46 | $ 0.43 |
| **Diluted earnings per share** | $ (0.18) | $ 0.44 | $ 0.45 | $ 0.44 |

Per share data has been retroactively adjusted to reflect a 10% stock dividend paid on June 22, 2007.

Summation of the quarterly net income per share does not necessarily equal the annual amount due the averaging effect of shares throughout the year.

During the fourth quarter of 2007 the Bank executed a business combination acquiring four full services branches and associated fixed assets, $78.0 million of deposits and $35.3 million of loans. The additional expense associated with the integration and operation of the branches acquired, in combination with a provision for loan losses of $285,000, due primarily to an increase in nonperforming loans, resulted in a reduced level of earnings.

During the fourth quarter 2006 the Bank repositioned its investment portfolio by selling $34 million of securities available for sale, which had below market yields. The transaction resulted in a $916,000 loss on sale of securities available for sale, which was the primary cause of the $262,000 fourth quarter 2006 loss.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**Board of Directors and Shareholders, The Elmira Savings Bank, FSB**

We have audited the accompanying consolidated balance sheets of The Elmira Savings Bank, FSB and subsidiaries (the "Bank") as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Oversight Accounting Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Elmira Savings Bank, FSB and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006 the Bank adopted the provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payment.*

KPMG LLP

March 27, 2008
Syracuse, New York

## MANAGEMENT'S STATEMENT OF RESPONSIBILITY

Management is responsible for preparation of the consolidated financial statements and related financial information contained in all sections of this annual report, including the determination of amounts that must necessarily be based on judgments and estimates. It is the belief of management that the consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances, and that the financial information appearing throughout this annual report is consistent with the consolidated financial statements.

Management establishes and monitors the Company's system of internal accounting controls to meet its responsibility for reliable financial statements. The system is designed to provide reasonable assurance that assets are safeguarded, and that transactions are executed in accordance with management's authorization and are property recorded.

The Audit Committee of the Board of Directors, composed solely of outside directors, meets periodically and privately with management, internal auditors, and independent auditors, KPMG LLP, to review matters relating to the quality of financial reporting, internal accounting control, and the nature, extent and results of audit efforts. The independent and internal auditors have unlimited access to the Audit Committee to discuss all such matters. The consolidated financial statements have been audited by the Company's independent auditors for the purpose of expressing an opinion on the consolidated financial statements.

Date: March 27, 2008

/s/ Michael P. Hosey______
Michael P. Hosey
President
Chief Executive Officer

/s/ Thomas M. Carr_____
Thomas M. Carr
Executive Vice President
Chief Operating Officer and
Chief Financial Officer

## Item 9 – Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

## Item 9A – Controls and Procedures

The Bank's management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Bank's disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934, as amended) (the "Exchange Act"). Based upon that evaluation, the Bank's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Bank's disclosure controls and procedures were effective in timely alerting them to any material information relating to the Bank and its subsidiaries required to be included in the Bank's Exchange Act filings.

There were no significant changes made in the Bank's internal controls over financial reporting during the fourth quarter.

The management of the Bank is responsible for establishing and maintaining adequate internal control over financial reporting. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Bank's financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted as assessment of the effectiveness of the Bank's internal control over financial reporting as of December 31, 2007, utilizing the framework established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO.) Based on this assessment, management has determined that the Bank's internal control over financial reporting as of December 31, 2007 is effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions and dispositions of assets; and provide reasonable assurances that: (1) transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America; (2) receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Bank's assets that could have a material effect on the Bank's financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

## Item 9B – Other Information

None

## PART III

### Item 10 – Directors and Executive Officers of the Bank

The information required herein with respect to directors and executive officers is incorporated herein by reference from the Proxy Statement filed with the OTS pursuant to Regulation 14A on March 27, 2008.

### Item 11 – Executive Compensation

Incorporated herein by reference from the Proxy Statement filed with the OTS pursuant to Regulation 14A on March 27, 2008.

### Item 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Incorporated herein by reference from the Proxy Statement filed with the OTS pursuant to Regulation 14A on March 27, 2008.

### Item 13 – Certain Relationships and Related Transactions

Incorporated herein by reference from the Proxy Statement filed with the OTS pursuant to Regulation 14A on March 27, 2008.

### Item 14 – Principal Accountant Fees and Services

Incorporated herein by reference from the Proxy Statement filed with the OTS pursuant to Regulation 14A on March 27, 2008.

## PART IV

### Item 15 – Exhibits and Financial Statement Schedules

(a) (1) All financial statement schedules have been omitted as they are not applicable, not required, or the information is included in the Consolidated Financial Statements or notes thereto.

(a) (2) Exhibits:

| | |
|---|---|
| Exhibit 21 | List of Registrant's Subsidiaries |
| Exhibit 22 | Proxy Statement dated March 27, 2008 |
| Exhibit 31.1 | Certification of the Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 31.2 | Certification of the Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.1 | Written statement of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.2 | Written statement of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002 |

(b) During the three-month period ended December 31, 2007, the Registrant filed seven reports on Form 8-K.

On October 5, 2007, The Elmira Savings Bank, FSB issued a press release announcing its intent to issue and sell 600,000 shares of its common stock.

On November 20, 2007, The Elmira Savings Bank, FSB issued a press release announcing the completion of the private placement of 189,376 shares of its common stock.

On November 21, 2007, The Elmira Savings Bank, FSB issued a press release announcing completion of the issuance and sale of 10,000 shares of a new series of preferred stock.

On November 30, 2007, The Elmira Savings Bank, FSB issued a press release announcing the sale of 98,000 shares of its common stock.

On December 3, 2007, The Elmira Savings Bank, FSB issued a press release announcing completion of the purchase of four First Niagara branches.

On December 7, 2007, The Elmira Savings Bank, FSB issued a press release declaring a $0.22 per share cash dividend on common shares outstanding.

On December 14, 2007, The Elmira Savings Bank, FSB issued a press release announcing completion of the purchase of commercial loans from First Niagara Financial Group.

(c) See (a) (2) above for all exhibits filed herewith.

(d) Not applicable.

Pursuant to the requirements of Section 13 or 15 (d) 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.

THE ELMIRA SAVINGS BANK, FSB
(Registrant)

BY: /s/ Michael P. Hosey DATE: March 27, 2008
Michael P. Hosey
President & Chief Executive Officer

BY: /s/ Thomas M. Carr DATE: March 27, 2008
Thomas M. Carr
Executive Vice President, Chief Operating Officer
And Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

BY: /s/ George L. Howell DATE: March 27, 2008
George L. Howell
Chairman of the Board

BY: /s/ John R. Alexander DATE: March 27, 2008
John R. Alexander, Director

BY: /s/ John Brand III DATE: March 27, 2008
John Brand III, Director

BY: /s/ Anthony J. Cooper DATE: March 27, 2008
Anthony J. Cooper, Director

BY: /s/ Jerry B. Gapp DATE: March 27, 2008
Jerry B. Gapp, Director

BY: /s/ Thomas D. Morse DATE: March 27, 2008
Thomas D. Morse, Director

BY: /s/ Kristin A. Swain DATE: March 27, 2008
Kristin A. Swain, Director

BY: /s/ A. Scott Welliver DATE: March 27, 2008
A. Scott Welliver, Director

## EXHIBIT 21

## LIST OF REGISTRANT'S SUBSIDIARIES

| Subsidiary | State of Incorporation |
| --- | --- |
| ESB Advisory Services, Inc. | New York |
| ESB Realty, Corp. | New York |

## EXHIBIT 31.1
## CERTIFICATION

I, Michael P. Hosey, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of The Elmira Savings Bank, FSB;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

   a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely

affect the registrant's ability to record, process, summarize and report financial information; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls, over financial reporting.

Date: March 27, 2008

/s/ Michael P. Hosey
Michael P. Hosey
President
Chief Executive Officer

**EXHIBIT 31.2**
**CERTIFICATION**

I, Thomas M. Carr, Executive Vice President, Chief Operating Officer and Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of The Elmira Savings Bank, FSB;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

   a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls, over financial reporting.

Date: March 27, 2008

/s/ Thomas M. Carr
Thomas M. Carr
Executive Vice President
Chief Operating Officer
Chief Financial Officer

## EXHIBIT 32.1

In connection with the filing of the annual report on Form 10-K for the fiscal year ended December 31, 2007 (the "Report") by The Elmira Savings Bank, FSB (the "Company",) the undersigned, as Chief Executive Officer of the Company, hereby certifies pursuant to 18 U.S.C., section 1350 as adopted pursuant to section 906 of The Sarbanes-Oxley Act of 2002, that, to my knowledge:

The report fully complies with the requirements of section 13(a) or section 15(d), as applicable, of the Securities Exchange Act of 1934; and

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 27, 2008

/s/ Michael P. Hosey
Michael P. Hosey
President
Chief Executive Officer

## EXHIBIT 32.2

In connection with the filing of the annual report on Form 10-K for the fiscal year ended December 31, 2007 (the "Report") by The Elmira Savings Bank, FSB (the "Company",) the undersigned, as Executive Vice President, Chief Operating Officer and Chief Financial Officer of the Company, hereby certifies pursuant to 18 U.S.C., section 1350 as adopted pursuant to section 906 of The Sarbanes-Oxley Act of 2002, that, to my knowledge:

The report fully complies with the requirements of section 13(a) or section 15(d), as applicable, of the Securities Exchange Act of 1934; and

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 27, 2008

/s/ Thomas M. Carr
Thomas M. Carr
Executive Vice President
Chief Operating Officer
Chief Financial Officer