

ARROW FINANCIAL CORP
Form 10-Q
May 10, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarter Ended March 31, 2007

or

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

Commission File Number: 0-12507

ARROW FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of
incorporation or organization)

22-2448962

(IRS Employer Identification
Number)

250 GLEN STREET, GLENS FALLS, NEW YORK 12801

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (518) 745-1000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for 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. x Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

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

<u>Class</u>	<u>Outstanding as of April 30, 2007</u>
Common Stock, par value \$1.00 per share	10,424,388

ARROW FINANCIAL CORPORATION

FORM 10-Q

March 31, 2007

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

	March 31, 2007	December 31, 2006
	<u>Unaudited</u>	<u>2006</u>
ASSETS		
Cash and Due from Banks	\$ 36,691	\$ 34,995
Federal Funds Sold	<u>33,000</u>	<u>9,000</u>
Cash and Cash Equivalents	<u>69,691</u>	<u>43,995</u>
Securities Available-for-Sale	307,836	315,886
Securities Held-to-Maturity (Approximate Fair Value of \$107,126 at March 31, 2007 and \$108,270 at December 31, 2006)	107,366	108,498
Loans	1,014,592	1,008,999
Allowance for Loan Losses	<u>(12,298)</u>	<u>(12,278)</u>
Net Loans	1,002,294	996,721
Premises and Equipment, Net	16,172	15,608
Other Real Estate and Repossessed Assets, Net	307	392
Goodwill	14,614	14,503
Other Intangible Assets, Net	2,303	2,422
Other Assets	<u>22,571</u>	<u>22,192</u>
Total Assets	<u>\$1,543,154</u>	<u>\$1,520,217</u>
LIABILITIES		
Deposits:		
Demand	\$ 184,094	\$ 183,492
Regular Savings, N.O.W. & Money Market Deposit Accounts	582,554	559,132
Time Deposits of \$100,000 or More	174,282	187,777
Other Time Deposits	<u>262,851</u>	<u>255,996</u>
Total Deposits	<u>1,203,781</u>	<u>1,186,397</u>
Short-Term Borrowings:		
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	46,275	47,566
Other Short-Term Borrowings	29	758

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Federal Home Loan Bank Advances	135,000	125,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000
Other Liabilities	<u>19,689</u>	<u>22,366</u>
Total Liabilities	<u>1,424,774</u>	<u>1,402,087</u>
SHAREHOLDERS EQUITY		
Preferred Stock, \$5 Par Value; 1,000,000 Shares Authorized	---	---
Common Stock, \$1 Par Value; 20,000,000 Shares Authorized		
(14,299,556 Shares Issued at March 31, 2007 and December 31, 2006)	14,300	14,300
Surplus	151,282	150,919
Undivided Profits	19,218	17,619
Unallocated ESOP Shares (106,684 Shares at March 31, 2007		
and 62,811 Shares at December 31, 2006)	(2,042)	(862)
Accumulated Other Comprehensive Loss	(7,095)	(7,965)
Treasury Stock, at Cost (3,700,604 Shares at March 31, 2007		
and 3,649,803 Shares at December 31, 2006)	<u>(57,283)</u>	<u>(55,881)</u>
Total Shareholders Equity	<u>118,380</u>	<u>118,130</u>
Total Liabilities and Shareholders Equity	<u>\$1,543,154</u>	<u>\$1,520,217</u>

See Notes to Unaudited Consolidated Interim Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF INCOME**

(In Thousands, Except Per Share Amounts) (Unaudited)

	Three Months Ended March 31,	
	<u>2007</u>	<u>2006</u>
INTEREST AND DIVIDEND INCOME		
Interest and Fees on Loans	\$15,957	\$14,767
Interest on Federal Funds Sold	251	30
Interest and Dividends on Securities Available-for-Sale	3,574	3,472
Interest on Securities Held-to-Maturity	<u>1,034</u>	<u>1,063</u>
Total Interest and Dividend Income	<u>20,816</u>	<u>19,332</u>
INTEREST EXPENSE		
Interest on Deposits:		
Time Deposits of \$100,000 or More	2,160	1,510
Other Deposits	5,214	4,003
Interest on Short-Term Borrowings:		
Federal Funds Purchased and Securities Sold		
Under Agreements to Repurchase	321	203
Other Short-Term Borrowings	4	8
Federal Home Loan Bank Advances	1,567	1,799
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	<u>348</u>	<u>327</u>
Total Interest Expense	<u>9,614</u>	<u>7,850</u>
NET INTEREST INCOME	11,202	11,482
Provision for Loan Losses	<u>94</u>	<u>273</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>11,108</u>	<u>11,209</u>
OTHER INCOME		
Income from Fiduciary Activities	1,453	1,303
Fees for Other Services to Customers	1,882	1,804
Insurance Commissions	501	422
Other Operating Income	<u>176</u>	<u>197</u>
Total Other Income	<u>4,012</u>	<u>3,726</u>
OTHER EXPENSE		
Salaries and Employee Benefits	5,317	5,471

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Occupancy Expense of Premises, Net	812	805
Furniture and Equipment Expense	755	757
Other Operating Expense	<u>2,477</u>	<u>2,121</u>
Total Other Expense	<u>9,361</u>	<u>9,154</u>
INCOME BEFORE PROVISION FOR INCOME TAXES	5,759	5,781
Provision for Income Taxes	<u>1,628</u>	<u>1,722</u>
NET INCOME	<u>\$ 4,131</u>	<u>\$ 4,059</u>
Average Shares Outstanding:		
Basic	10,564	10,669
Diluted	10,646	10,824
Per Common Share:		
Basic Earnings	\$.39	\$.38
Diluted Earnings	.39	.38

Share and Per Share amounts have been restated for the September 2006 3% stock dividend.

See Notes to Unaudited Consolidated Interim Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In Thousands, Except Share and Per Share Amounts) (Unaudited)

	Shares Common		Undivided	ESOP	Unallo- Accumulated		Treasury	Total
	Issued	Stock			Other Com-	ated		
		Surplus	Profits	Shares	(Loss)	Stock		
Balance at December 31, 2006	14,299,556	\$14,300	\$150,919	\$17,619	\$ (862)	\$ (7,965)	\$(55,881)	\$118,130
Comprehensive Income, Net of Tax:								
Net Income	---	---	---	4,131	---	---	---	4,131
Net Pension Plan Actuarial Loss	---	---	---	---	---	34	---	34
Net Pension Plan Prior Service Credit	---	---	---	---	---	(28)	---	(28)
Net Unrealized Securities Holding Gains Arising During the Period,								
Net of Tax (Pre-tax \$1,431)	---	---	---	---	---	864	---	<u>864</u>
Comprehensive Income								<u>5,001</u>
Cash Dividends Paid,								
\$.24 per Share	---	---	---	(2,532)	---	---	---	(2,532)
Stock Options Exercised								
(14,058 Shares)	---	---	2	---	---	---	215	217
	---	---	1	---	---	---	1	2

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Shares Issued Under the
Directors

Stock Plan (62 Shares)
Shares Issued Under the
Employee

Stock Purchase Plan
(5,004

Shares)	---	---	37	---	---	---	77	114
Stock-Based Compensation								
Expense	---	---	16	---	---	---	---	16
Tax Benefit for Disposition of								
Stock Options	---	---	37	---	---	---	---	37
Acquisition by ESOP of Arrow Stock								
(67,190 Shares)	---	---	---	---	(1,500)	---	---	(1,500)
Allocation of ESOP Stock								
(23,317 Shares)	---	---	225	---	320	---	---	545
Acquisition of Subsidiary								
(4,317 Shares)	---	---	45	---	---	---	66	111
Purchase of Treasury Stock								
(74,242 Shares)	---	---	---	---	---	---	(1,761)	(1,761)
Balance at March 31, 2007	<u>14,299,556</u>	<u>\$14,300</u>	<u>\$151,282</u>	<u>\$19,218</u>	<u>\$(2,042)</u>	<u>\$(7,095)</u>	<u>\$(57,283)</u>	<u>\$118,380</u>

	Unallo- Accumulated							
	cated Other Com-							
	Shares	Common		Undivided	ESOP	prehensive	Treasury	
	<u>Issued</u>	<u>Stock</u>	<u>Surplus</u>	<u>Profits</u>	<u>Shares</u>	<u>(Loss)</u>	<u>Stock</u>	<u>Total</u>
	13,883,064	\$13,883	\$139,442	\$21,402	\$(1,163)	\$ (4,563)	\$(51,580)	\$117,421

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Balance at December 31, 2005								
Comprehensive Income, Net of Tax:								
Net Income	---	---	---	4,059	---	---	---	4,059
Net Unrealized Securities Holding								
Losses Arising During the Period,								
Net of Tax (Pre-tax \$2,965)	---	---	---	---	---	(1,783)	---	<u>(1,783)</u>
Comprehensive Income								<u>2,276</u>
Cash Dividends Declared,								
\$.233 per Share	---	---	---	(2,480)	---	---	---	(2,480)
Stock Options Exercised								
(1,996 Shares)	---	---	9	---	---	---	17	26
Shares Issued Under the Employee								
Stock Purchase Plan (4,685								
Shares)	---	---	74	---	---	---	41	115
Allocation of ESOP Stock								
(21,969 Shares)	---	---	269	---	301	---	---	570
Purchase of Treasury Stock								
(51,063 Shares)	---	---	---	---	---	---	(1,345)	(1,345)
Balance at March 31, 2006	<u>13,883,064</u>	<u>\$13,883</u>	<u>\$139,794</u>	<u>\$22,981</u>	<u>\$ (862)</u>	<u>\$(6,346)</u>	<u>\$(52,867)</u>	<u>\$116,583</u>

See Notes to Unaudited Consolidated Interim Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands) (Unaudited)

	Three Months Ended March 31,	
	<u>2007</u>	<u>2006</u>
Operating Activities:		
Net Income	\$ 4,131	\$ 4,059
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Loan Losses	94	273
Depreciation and Amortization	766	703
Compensation Expense for Allocated ESOP Shares	225	269
Loans Originated and Held-for-Sale	(797)	(4,092)
Proceeds from the Sale of Loans Held-for-Sale	174	3,318
Net Gains on the Sale of Loans	(5)	(43)
Net Gains on the Sale of Premises and Equipment,		
Other Real Estate Owned and Repossessed Assets	(4)	(6)
Contributions to Pension Plans	(123)	(64)
Deferred Income Tax Expense	30	11
Stock-Based Compensation Expense	16	---
Net Increase in Other Assets	(1,115)	(1,194)
Net Decrease in Other Liabilities	<u>(2,548)</u>	<u>(235)</u>
Net Cash Provided By Operating Activities	<u>844</u>	<u>2,999</u>
Investing Activities:		
Proceeds from the Sale of Securities Available-for-Sale	---	5,808
Proceeds from the Maturities and Calls of Securities Available-for-Sale	11,368	6,313
Purchases of Securities Available-for-Sale	(2,005)	(8,847)
Proceeds from the Maturities of Securities Held-to-Maturity	1,077	7,059
Net (Increase) Decrease in Loans	(5,197)	8
Proceeds from the Sales of Premises and Equipment,		
Other Real Estate Owned and Repossessed Assets	249	190
Purchases of Premises and Equipment	<u>(901)</u>	<u>(416)</u>
Net Cash Provided By Investing Activities	<u>4,591</u>	<u>10,115</u>
Financing Activities:		
Net Increase in Deposits	17,384	3,823

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Net Decrease in Short-Term Borrowings	(2,020)	(4,435)
Federal Home Loan Bank Advances	10,000	---
Federal Home Loan Bank Repayments	---	(12,000)
Tax Benefit for Disposition of Stock Options	37	---
Common Stock Purchased by ESOP	(1,500)	---
Allocation of ESOP Shares	320	301
Exercise of Stock Options and Shares Issued to Employees	333	141
Stock Purchase Plan		
Purchases of Treasury Stock	(1,761)	(1,345)
Cash Dividends Paid	<u>(2,532)</u>	<u>(2,480)</u>
Net Cash Provided By (Used In) Financing Activities	<u>20,261</u>	<u>(15,995)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	25,696	(2,881)
Cash and Cash Equivalents at Beginning of Period	<u>43,995</u>	<u>35,558</u>
Cash and Cash Equivalents at End of Period	<u>\$69,691</u>	<u>\$32,677</u>
Supplemental Cash Flow Information:		
Cash Paid During the Year for:		
Interest on Deposits and Borrowings	\$8,494	\$7,098
Income Taxes	5,902	3,100
Non-cash Investing and Financing Activities:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	158	172
Changes in the Valuation Allowance for Securities Available-for-Sale, Net of Tax	864	(1,783)
Shares Issued for CFG Acquisition	111	---
Change in Pension Liability Recognized in Other Comprehensive Income	6	---

See Notes to Unaudited Consolidated Interim Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

FORM 10-Q

March 31, 2007

1. Financial Statement Presentation

In the opinion of the management of Arrow Financial Corporation (Arrow), the accompanying unaudited consolidated interim financial statements contain all of the adjustments necessary to present fairly the financial position as of March 31, 2007; the results of operations for the three-month periods ended March 31, 2007 and 2006; the changes in shareholders' equity for the three-month periods ended March 31, 2007 and 2006; and the cash flows for the three-month periods ended March 31, 2007 and 2006. All such adjustments are of a normal recurring nature. The unaudited consolidated interim financial statements should be read in conjunction with the audited annual consolidated financial statements of Arrow for the year ended December 31, 2006, included in Arrow's 2006 Form 10-K.

2. Accumulated Other Comprehensive Loss (In Thousands)

The following table presents the components, net of tax, of accumulated other comprehensive loss as of March 31, 2007 and December 31, 2006:

	<u>2007</u>	<u>2006</u>
Excess of Additional Pension Liability Over Unrecognized Prior Service Cost	\$(4,232)	\$ (4,238)
Net Unrealized Securities Holding Losses	<u>(2,863)</u>	<u>(3,727)</u>
Total Accumulated Other Comprehensive Loss	<u>\$(7,095)</u>	<u>\$(7,965)</u>

3. Earnings Per Common Share (In Thousands, Except Per Share Amounts)

The following table presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted earnings per common share (EPS) for the three-month periods ended March 31, 2007 and 2006:

	<u>Income</u> <u>(Numerator)</u>	<u>Shares</u> <u>(Denominator)</u>	<u>Per Share</u> <u>Amount</u>
For the Three Months Ended March 31, 2007:			
Basic EPS	\$4,131	10,564	<u>\$.39</u>
Dilutive Effect of Stock Options	<u>---</u>	<u>82</u>	
Diluted EPS	<u>\$4,131</u>	<u>10,646</u>	<u>\$.39</u>
For the Three Months Ended March 31, 2006:			
Basic EPS	\$4,059	10,669	<u>\$.38</u>
Dilutive Effect of Stock Options	<u>---</u>	<u>155</u>	
Diluted EPS	<u>\$4,059</u>	<u>10,824</u>	<u>\$.38</u>

4. Stock-Based Compensation Plans (Dollars In Thousands)

On January 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123(R) Accounting for Stock-Based Compensation using the modified prospective method. Under this method, SFAS No. 123(R) requires that we measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date for all awards granted after December 31, 2005. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (i.e. the vesting period), which is typically four years for Arrow. Under our 1998 Long-Term Incentive Plan, we granted options to purchase 45,000 shares of our common stock in 2006. The amount expensed for the three-month period ending March 31, 2007 was \$16. There was no expense in the 2006 period.

No stock options have been granted in 2007, to date. The weighted-average fair value of options granted during 2006 was \$5.86. The fair value was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield - 3.86%; expected volatility - 27.2%; risk free interest rate - 4.81%; and an expected life of 7.42 years.

Arrow also sponsors an Employee Stock Purchase Plan (ESPP) under which employees purchase Arrow's common stock at a 5% discount below market price. Under SFAS No. 123(R), a stock purchase plan with a discount of 5% or less is not considered a compensatory plan.

The following table presents the activity in Arrow's stock option plans for the first quarter of 2007 and 2006:

<u>2007</u>	<u>2006</u>
Weighted-	Weighted-

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		Average		Average
		Exercise		Exercise
Options:	<u>Shares</u>	<u>Price</u>	<u>Shares</u>	<u>Price</u>
Outstanding at January 1	535,059	\$20.61	553,251	\$19.30
Granted	---	---	---	---
Exercised	(14,058)	15.53	(1,996)	13.10
Forfeited	<u>---</u>	---	<u>---</u>	---
Outstanding at March 31	<u>521,001</u>	20.75	<u>551,255</u>	19.32
Exercisable at March 31	475,954	20.36	551,255	19.32

5. Guarantees

Arrow does not issue any guarantees that would require liability-recognition or disclosure, other than its standby letters of credit. Standby and other letters of credit are conditional commitments issued by Arrow to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Typically, these instruments have terms of twelve months or less. Some expire unused, and therefore, the total amounts do not necessarily represent future cash requirements. Some have automatic renewal provisions.

For letters of credit, the amount of the collateral obtained, if any, is based on management's credit evaluation of the counter-party. Arrow had approximately \$1.8 million of standby letters of credit on March 31, 2007, most of which will expire within one year and some of which were not collateralized. At that date, all the letters of credit were for private borrowing arrangements. The fair value of Arrow's standby letters of credit at March 31, 2007 was insignificant.

6. Retirement Plans (In Thousands)

The following table provides the components of net periodic benefit costs for the three months ended March 31:

	Pension		Postretirement	
	<u>Benefits</u>		<u>Benefits</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Service Cost	\$216	\$312	\$ 44	\$ 31

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Interest Cost	289	408	105	104
Expected Return on Plan Assets	(442)	(591)	---	---
Amortization of Prior Service Credit	(30)	(28)	(15)	(14)
Amortization of Transition Obligation	---	---	---	8
Amortization of Net Loss	<u>67</u>	<u>128</u>	<u>20</u>	<u>32</u>
Net Periodic Benefit Cost	<u>\$100</u>	<u>\$229</u>	<u>\$154</u>	<u>\$161</u>

Arrow will review the current-year funding of its qualified pension plan later in 2007 and may make a contribution, if appropriate. The expected contribution for the nonqualified pension plan is \$288 for all of 2007. The expected contribution for our postretirement benefit plan is estimated to be \$322 for the 2007 year.

7. Accounting for Uncertainty in Income Taxes

On January 1, 2007 we adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). The adoption of FIN 48 did not result in an increase or decrease to our income tax liability. Our accounting policy calls for any interest expense and/or penalties related to the underpayment of income taxes to be recorded as a component of the provision for income taxes. There was no material accrual for interest expense or penalties at January 1, 2007 or at March 31, 2007.

Also, there was no material interest expense or penalties recognized during the quarter ended March 31, 2007. There were no material unrecognized tax benefits as a result of tax positions taken prior to January 1, 2007, or for the quarter ended March 31, 2007. At March 31, 2007, tax returns for calendar years 2003 to 2005 were open to examination by the Internal Revenue Service. During the second quarter of 2007, the New York State Department of Taxation and Finance began an examination of our bank franchise tax returns filed for 2003 to 2005, the only years open to examination.

8. Recently Issued Accounting Pronouncements

FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS No. 159) issued in February 2007, permits entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. The fair value option may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method. The election is irrevocable (unless a new election date occurs) and is applied only to entire instruments and not to portions of instruments. FAS No. 159 is effective for fiscal years beginning after November 15, 2007. The adoption of this standard is not expected to have a material effect on Arrow's results of operations or financial position.

On December 31, 2006, Arrow adopted the recognition requirements of SFAS Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (an amendment of FASB Statements No. 87, 88, 106, and 132R). Issued in September 2006, SFAS No. 158 completed the first phase of FASB's comprehensive project to improve the accounting and reporting for defined benefit pension and other postretirement plans. FAS No. 158 requires an employer to:

Recognize the funded status of a benefit plan measured as the difference between plan assets at fair value (with limited exceptions) and the benefit obligation in its consolidated balance sheet. For a pension plan, the benefit obligation is the projected benefit obligation; for any other postretirement benefit plan, such as a retiree health care plan, the benefit obligation is the accumulated postretirement benefit obligation.

Recognize as a component of other comprehensive income (loss), net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to FASB Statement No. 87, *Employers' Accounting for Pensions*, or No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. Amounts recognized in accumulated other comprehensive income, including the gains or losses, prior service costs or credits, and the transition assets or obligations remaining from the initial application of Statements 87 and 106, are adjusted as they are subsequently recognized as components of net periodic benefit cost pursuant to the

recognition and amortization provisions of those Statements.

Measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end consolidated balance sheet (with limited exceptions).

Disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition assets or obligations.

Effective December 31, 2006, SFAS No. 158 required Arrow to recognize the overfunded or underfunded status of our single employer defined benefit postretirement plan as an asset or liability on its consolidated balance sheet and to recognize changes in the funded status in comprehensive income in the year in which the change occurred. However, gains or losses, prior services costs or credits, and transition assets or obligations that have not yet been included in net periodic benefit cost as of the end of 2006, the fiscal year in which SFAS No. 158 is initially applied, were recognized as components of the ending balance of accumulated other comprehensive income (loss), net of tax. Amortization subsequent to December 31, 2006 has been recognized as a component of other comprehensive income.

Arrow currently complies with the future requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end balance sheet.

FASB Statement No. 157, Fair Value Measurements (FAS No. 157) issued in September 2006, defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. FAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. The provisions of FAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007. The adoption of this standard is not expected to have a material effect on Arrow's results of operations or financial position.

FASB Statement No. 155 Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (FAS No. 155) was issued in February 2006. FAS No. 155 amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. FAS No. 155 resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. FAS No. 155:

Permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation,

Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133,

Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation,

Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and

Amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

For Arrow, FAS No. 155 is effective for all financial instruments acquired or issued after December 31, 2006. FAS No. 155 did not have any material impact on Arrow's results of operations or financial position for the quarter ending March 31, 2007.

Independent Auditors' Review Report

The Board of Directors and Shareholders

Arrow Financial Corporation

We have reviewed the consolidated balance sheet of Arrow Financial Corporation and subsidiaries (the Company) as of March 31, 2007, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the three-month periods ended March 31, 2007 and 2006. These consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Arrow Financial Corporation and subsidiaries as of December 31, 2006, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 12, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Albany, New York

May 8, 2007

Item 2.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
MARCH 31, 2007

Note on Terminology - In this Quarterly Report on Form 10-Q, the terms Arrow, the registrant, the company, we, and our generally refer to Arrow Financial Corporation and its subsidiaries as a group, except where the context indicates otherwise. Arrow is a two-bank holding company headquartered in Glens Falls, New York. Our banking subsidiaries are Glens Falls National Bank and Trust Company (Glens Falls National) whose main office is located in Glens Falls, New York, and Saratoga National Bank and Trust Company (Saratoga National) whose main office is located in Saratoga Springs, New York. Our non-bank subsidiaries include Capital Financial Group, Inc. (an insurance agency specializing in selling and servicing group health care policies), North Country Investment Advisers, Inc. (a registered investment adviser that provides investment advice to our proprietary mutual funds) and Arrow Properties, Inc., (a real estate investment trust, or REIT), all of which are subsidiaries of Glens Falls National.

At certain points in this Report, our performance is compared with that of our peer group of financial institutions. Unless otherwise specifically stated, this peer group is comprised of the group of 265 domestic bank holding companies with \$1 to \$3 billion in total consolidated assets as identified in the Federal Reserve Board's Bank Holding Company Performance Report for December 2006, and peer group data has been derived from such Report.

Forward Looking Statements - The information contained in this Quarterly Report on Form 10-Q contains statements that are not historical in nature but rather are based on our beliefs, assumptions, expectations, estimates and projections about the future. These statements are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and involve a degree of uncertainty and attendant risk. Words such as expects, believes, anticipates, estimates and variations of such words and similar expressions are intended to identify such forward-looking statements. Some of these statements, such as those included in the interest rate sensitivity analysis in Item 3, entitled Quantitative and Qualitative Disclosures About Market Risk, are merely presentations of what future performance or changes in future performance would look like based on hypothetical assumptions and on simulation models. Other forward-looking statements are based on our general perceptions of market conditions and trends in activity, both locally and nationally, as well as current management strategies for future operations and development.

Examples of forward-looking statements in this Report are referenced in the table below:

<u>Topic</u>	<u>Page</u>	<u>Location</u>
Impact of market rate structure on net interest margin, loan yields and deposit rates	18	2 nd paragraph
	19	Last paragraph
	20	Last paragraph
Change in the level of loan losses and nonperforming loans and assets	21	1 st paragraph under table
	22	1 st paragraph
	23	2 nd paragraph
Future level of residential real estate loans	19	1 st paragraph
Impact of competition for indirect loans	19	5 th paragraph
Liquidity	25	4 th paragraph

These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to quantify or, in some cases, to identify. In the case of all forward-looking statements, actual outcomes and results may differ materially from what the statements predict or forecast. Factors that could cause or contribute to such differences include, but are not limited to, unexpected changes in economic and market conditions, including unanticipated fluctuations in interest rates; new developments in state and federal regulation; enhanced competition from unforeseen sources; new emerging technologies; unexpected loss of key personnel; unanticipated business opportunities; and similar uncertainties inherent in banking operations or business generally.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to revise or update these forward-looking statements to reflect the occurrence of unanticipated events. This Quarterly Report should be read in conjunction with our Annual Report on Form 10-K for December 31, 2006.

USE OF NON-GAAP FINANCIAL MEASURES

The Securities and Exchange Commission (SEC) has adopted Regulation G, which applies to all public disclosures, including earnings releases, made by registered companies that contain non-GAAP financial measures. GAAP is generally accepted accounting principles in the United States of America. Under Regulation G, companies making public disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure and a statement of the company's reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. As a parallel measure with Regulation G, the SEC stipulated in Item 10 of its Regulation S-K that public companies must make the same types of supplemental disclosures whenever they include non-GAAP financial measures in their filings with the SEC. The SEC has exempted from the definition of non-GAAP financial measures certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures or SEC filings, supplemental information is not required. The following measures used in this Report, which although commonly utilized by financial institutions have not been specifically exempted by the SEC, may constitute "non-GAAP financial measures" within the meaning of the SEC's new rules, although we are unable to state with certainty that the SEC would so regard them.

Tax-Equivalent Net Interest Income and Net Interest Margin: Net interest income, as a component of the tabular presentation by financial institutions of Selected Financial Information regarding their recently completed operations, is commonly presented on a tax-equivalent basis. That is, to the extent that some component of the institution's net interest income which is presented on a before-tax basis, is exempt from taxation (e.g., is received by the institution as a result of its holdings of state or municipal obligations), an amount equal to the tax benefit derived from that component is added back to the net interest income total. This adjustment is considered helpful in comparing one financial institution's net interest income to that of another institution, to correct any distortion that might otherwise arise from the fact that the two institutions typically will have different proportions of tax-exempt items in their portfolios. Moreover, net interest income is itself a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, tax-equivalent net interest income is generally used by financial institutions, again to provide a better basis of comparison from institution to institution. We follow these practices.

The Efficiency Ratio: Financial institutions often use an "efficiency ratio" as a measure of expense control. The efficiency ratio typically is defined as the ratio of noninterest expense to net interest income and noninterest income. Net interest income as utilized in calculating the efficiency ratio is typically expressed on a tax-equivalent basis. Moreover, most financial institutions, in calculating the efficiency ratio, also adjust both noninterest expense and noninterest income to exclude from these items (as calculated under GAAP) certain component elements, such as intangible asset amortization (deducted from noninterest expense) and securities gains or losses (excluded from noninterest income). We follow these practices.

Tangible Book Value per Share: Tangible equity is total shareholders' equity less intangible assets. Tangible book value per share is tangible equity divided by total shares issued and outstanding. Tangible book value per share is often a more meaningful comparative ratio than unadjusted book value per share.

Selected Quarterly Information:

(In Thousands, Except Per Share Amounts)

Per share amounts have been restated for the September 2006 3% stock dividend.

	<u>Mar 2007</u>	<u>Dec 2006</u>	<u>Sep 2006</u>	<u>Jun 2006</u>	<u>Mar 2006</u>
Net Income	\$4,131	\$4,295	\$4,261	\$4,277	\$4,059
<u>Transactions Recorded in Net Income (Net of Tax):</u>					
Net Securities Gains (Losses)	---	10	---	(71)	---
Net Gains on Sales of Loans	3	7	5	7	26
Net Gains on the Sale of Premises	---	---	---	136	---
Period End Shares Outstanding	10,492	10,587	10,562	10,558	10,655
Basic Average Shares Outstanding	10,564	10,578	10,561	10,607	10,669
Diluted Average Shares Outstanding	10,646	10,700	10,710	10,749	10,824
Basic Earnings Per Share	.39	\$.41	\$.40	\$.40	\$.38
Diluted Earnings Per Share	.39	.40	.40	.40	.38
Cash Dividends Per Share	.24	.24	.23	.23	.23
Stock Dividends/Splits	---	---	3%	---	---
Average Assets	\$1,525,423	\$1,530,566	\$1,515,722	\$1,523,164	\$1,519,810
Average Equity	118,532	120,097	116,683	115,626	117,439
Return on Average Assets	1.10%	1.11%	1.12%	1.13%	1.08%
Return on Average Equity	14.13	14.19	14.49	14.84	14.02
Average Earning Assets	\$1,456,018	\$1,458,211	\$1,444,772	\$1,454,397	\$1,449,220
Average Paying Liabilities	1,202,593	1,203,444	1,190,138	1,207,062	1,205,953
Interest Income, Tax-Equivalent ¹	21,530	21,388	20,986	20,651	19,974
Interest Expense	9,614	9,488	8,893	8,512	7,850
Net Interest Income, Tax-Equivalent ¹	11,916	11,900	12,093	12,139	12,124
Tax-Equivalent Adjustment	714	557	546	643	642
Net Interest Margin ¹	3.32%	3.24%	3.32%	3.35%	3.39%

Efficiency Ratio Calculation:¹

Noninterest Expense	\$ 9,361	\$ 9,120	\$ 9,202	\$ 9,331	\$ 9,154
Less: Intangible Asset Amortization	<u>(106)</u>	<u>(107)</u>	<u>(106)</u>	<u>(106)</u>	<u>(117)</u>
Net Noninterest Expense	<u>\$ 9,255</u>	<u>\$ 9,013</u>	<u>\$ 9,096</u>	<u>\$ 9,225</u>	<u>\$ 9,037</u>
Net Interest Income, Tax-Equivalent ¹	\$11,916	\$11,900	\$12,093	\$12,139	\$12,124
Noninterest Income	4,012	3,973	4,030	4,052	3,726
Less: Net Securities (Gains) Losses	<u>---</u>	<u>(16)</u>	<u>---</u>	<u>118</u>	<u>---</u>
Net Gross Income	<u>\$15,928</u>	<u>\$15,857</u>	<u>\$16,123</u>	<u>\$16,309</u>	<u>\$15,850</u>
Efficiency Ratio ¹	58.11%	56.84%	56.42%	56.56%	57.02%

Period-End Capital Information:

Tier 1 Leverage Ratio	8.62%	8.63%	8.51%	8.32%	8.46%
Total Shareholders' Equity (i.e. Book Value)	\$118,380	\$118,130	\$119,373	\$114,746	\$116,583
Book Value per Share	11.28	11.16	11.30	10.87	10.94
Intangible Assets	16,917	16,925	17,044	17,164	17,231
Tangible Book Value per Share ¹	9.67	9.56	9.69	9.24	9.32

Asset Quality Information:

Net Loans Charged-off as a

Percentage of Average Loans, Annualized Provision for Loan Losses as a	.03%	.10%	.07%	.04%	.11%
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Percentage of Average Loans, Annualized Allowance for Loan Losses as a	.04	.11	.07	.04	.11
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Percentage of Loans, Period-end Allowance for Loan Losses as a	1.21	1.22	1.24	1.23	1.23
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Percentage of Nonperforming Loans, Period-end Nonperforming Loans as a	603.43	442.12	928.41	931.30	988.94
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Percentage of Loans, Period-end Nonperforming Assets as a	.20	.28	.13	.13	.12
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Percentage of Total Assets, Period-end	.15	.21	.11	.09	.09
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¹ See Use of Non-GAAP Financial Measures on page 12.

Average Consolidated Balance Sheets and Net Interest Income Analysis

(see Use of Non-GAAP Financial Measures on page 12)

(Fully Taxable Basis using a marginal tax rate of 35%)

(Dollars In Thousands)

	<u>2007</u>			<u>2006</u>		
	Average <u>Balance</u>	Interest Income/ <u>Expense</u>	Rate Earned/ <u>Paid</u>	Average <u>Balance</u>	Interest Income/ <u>Expense</u>	Rate Earned/ <u>Paid</u>
Federal Funds Sold	\$ 19,378	\$ 251	5.25%	\$ 2,733	\$ 30	4.45%
Securities Available-for-Sale:						
Taxable	295,052	3,340	4.59	322,547	3,384	4.25
Non-Taxable	22,886	351	6.22	9,636	133	5.60
Securities Held-to-Maturity:						
Taxable	321	4	5.05	383	5	5.29
Non-Taxable	107,796	1,544	5.81	114,361	1,573	5.58
Loans	<u>1,010,585</u>	<u>16,040</u>	6.44	<u>999,560</u>	<u>14,849</u>	6.02
Total Earning Assets	1,456,018	<u>21,530</u>	6.00	1,449,220	<u>19,974</u>	5.59
Allowance For Loan Losses	(12,300)			(12,229)		
Cash and Due From Banks	32,068			33,841		
Other Assets	<u>49,637</u>			<u>48,978</u>		
Total Assets	<u>\$1,525,423</u>			<u>\$1,519,810</u>		
Deposits:						
Interest-Bearing NOW Deposits	\$ 292,559	1,428	1.98	\$ 300,259	1,160	1.57
Regular and Money Market Savings	267,877	961	1.45	292,141	836	1.16
Time Deposits of \$100,000 or More	182,254	2,160	4.81	153,730	1,510	3.98
Other Time Deposits	<u>259,913</u>	<u>2,825</u>	4.41	<u>233,807</u>	<u>2,007</u>	3.48
Total Interest-Bearing Deposits	1,002,603	7,374	2.98	979,937	5,513	2.28
Short-Term Borrowings	46,212	325	2.85	38,848	211	2.20

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Long-Term Debt	<u>153,778</u>	<u>1,915</u>	5.05	<u>187,168</u>	<u>2,126</u>	4.61
Total Interest-Bearing Liabilities	1,202,593	<u>9,614</u>	3.24	1,205,953	<u>7,850</u>	2.64
Demand Deposits	179,781			177,398		
Other Liabilities	<u>24,517</u>			<u>19,020</u>		
Total Liabilities	1,406,891			1,402,371		
Shareholders' Equity	<u>118,532</u>			<u>117,439</u>		
Total Liabilities and Shareholders' Equity	<u>\$1,525,423</u>			<u>\$1,519,810</u>		
Net Interest Income (Fully Taxable Basis)		11,916			12,124	
Net Interest Spread			2.76			2.95
Net Interest Margin			3.32			3.39
Reversal of Tax-Equivalent Adjustment		<u>(714)</u>	(.20)		<u>(642)</u>	(.18)
Net Interest Income, As Reported		<u>\$11,202</u>			<u>\$11,482</u>	

OVERVIEW

We reported earnings of \$4.131 million for the first quarter of 2007, an increase of \$72 thousand, or 1.8%, as compared to \$4.059 million for the first quarter of 2006. Diluted earnings per share were \$.39 and \$.38, for the respective quarters, an increase of one cent, or 2.6%. The percentage increase in earnings per share was greater than the increase in earnings due to a decrease in the number of shares outstanding, as our repurchases of our common stock exceeded our issuance of common stock upon option exercises. The modest increase in earnings between the two quarters was the result of the offsetting effects of a decrease in tax-equivalent net interest income, a decrease in the provision for loan losses, an increase in other (noninterest) income, an increase in other expense and a decrease in the provision for income taxes.

The returns on average assets were 1.10% and 1.08% for the first quarters of 2007 and 2006, respectively, an increase of 2 basis points, or 1.9%. The returns on average equity were 14.13% and 14.02% for the first quarters of 2007 and 2006, respectively, an increase of 11 basis points, or 0.8%.

Total assets were \$1.543 billion at March 31, 2007, which represented an increase of \$37.3 million, or 2.5%, above the level at March 31, 2006, and an increase of \$22.9 million, or 1.5%, from the December 31, 2006 level. The increase from the year-end total was primarily attributable to the electronic deposit of state funds into municipal accounts on the last day of March.

Shareholders' equity was \$118.4 million at March 31, 2007, an increase of \$1.8 million, or 1.5%, from the year earlier level. Shareholders' equity increased \$250 thousand from the December 31, 2006 level of \$118.1 million. The components of the change in shareholders' equity since year-end are presented in the Consolidated Statement of Changes in Shareholders' Equity on page 5. Included in the first quarter 2007 change as a charge against shareholders' equity was Arrow's guarantee of a \$1.5 million loan to our Employee Stock Ownership Plan (ESOP). The loan proceeds were used by the ESOP to purchase shares of Arrow Common Stock. Initially, the shares are not allocated to individual employees, and as long as the shares remain unallocated, the value thereof is reflected as a reduction to shareholders' equity. Our risk-based capital ratios and Tier 1 leverage ratio continued to exceed regulatory minimum requirements at period-end. At March 31, 2007 both of our banks, as well as the holding company, qualified as "well-capitalized" under federal bank regulatory guidelines. Efficient utilization of capital remains a high priority of Arrow.

CHANGE IN FINANCIAL CONDITION

Selected Consolidated Balance Sheet Data

(Dollars in Thousands)

	<u>At Period-End</u>			<u>\$ Change</u>	<u>\$ Change</u>	<u>% Change</u>	<u>% Change</u>
	<u>Mar 2007</u>	<u>Dec 2006</u>	<u>Mar 2006</u>	<u>From Dec</u>	<u>From Mar</u>	<u>From Dec</u>	<u>From Mar</u>
Federal Funds Sold	\$ 33,000	\$ 9,000	\$ 5,500	\$24,000	\$27,500	266.7 %	500.0 %
Securities Available-for-Sale	307,836	315,886	319,901	(8,050)	(12,065)	(2.5)	(3.8)
Securities Held-to-Maturity	107,366	108,498	111,010	(1,132)	(3,644)	(1.0)	(3.3)
Loans, Net of Unearned Income (1)	1,014,592	1,008,999	996,922	5,593	17,670	0.6	1.8
Allowance for Loan Losses	12,298	12,278	12,253	20	45	0.2	0.4
Earning Assets (1)	1,462,794	1,442,383	1,433,333	20,411	29,461	1.4	2.1
Total Assets	1,543,154	1,520,217	1,505,854				