PENNS WOODS BANCORP INC
Form DEF 14A
March 22, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x

Filed by a Party other than the Registrant o

Check the appropriate box:

o	Preliminary Proxy Statement
o	**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x	Definitive Proxy Statement
o	Definitive Additional Materials
o	Soliciting Material Pursuant to §240.14a-12

PENNS WOODS BANCORP, INC.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x	No fee required.	
o	Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.	
	(1)	Title of each class of securities to which transaction applies:
	(2)	Aggregate number of securities to which transaction applies:
	(3)	Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
	(4)	Proposed maximum aggregate value of transaction:
	(5)	Total fee paid:
o	Fee paid previously with preliminary materials.	
o	Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.	
	(1)	Amount Previously Paid:
	(2)	Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

2011 PROXY

PENNS
WOODS
BANCORP, INC.

PENNS WOODS BANCORP, INC.
300 Market Street
Williamsport, PA 17701

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To Our Shareholders:

The Annual Meeting of Shareholders of Penns Woods Bancorp, Inc. (the Corporation) will be held at the Holiday Inn Williamsport, 100 Pine Street, Williamsport, PA 17701, on Wednesday, April 27, 2011 at 1:00 P.M. Only holders of record at the close of business on March 1, 2011, are entitled to notice of and to vote at the Annual Meeting and any adjournment or postponement thereof.

At the 2011 Annual Meeting we will:

1. Elect four (4) Class 3 director nominees of the Board of Directors, to serve for a three-year term that will expire in 2014, and until their successors are elected and qualified (Proposal No. 1);

2. Ratify the appointment by the Corporation s Board of Directors of S.R. Snodgrass, A.C., of Wexford, Pennsylvania, Certified Public Accountants as the independent registered public accounting firm for the Corporation for the year ending December 31, 2011 (Proposal No. 2);

3. Conduct a non-binding (advisory) vote on executive compensation (Proposal No. 3);

4. Conduct a non-binding (advisory) vote on the frequency of future shareholder votes on executive compensation (Proposal No. 4); and

5. Transact such other business as may properly come before the Annual Meeting, and any adjournment or postponement thereof.

The Board of Directors recommends that you vote FOR each of the director nominees listed above, that you vote two years for how frequently a shareholder vote to approve executive compensation should occur, and that you vote FOR each of the other proposals.

You are urged to mark, sign, date, and promptly return your proxy in the enclosed postage-paid envelope so that your shares may be voted in accordance with your wishes and in order that the presence of a quorum may be assured. The prompt return of your proxy, regardless of the number of shares you hold, will aid the Corporation in reducing the expense of additional proxy solicitation.

You may access the following proxy materials at http://www.cfpproxy.com/4823:

- Notice of the 2011 Annual Meeting of Shareholders;
- the 2011 Proxy Statement of the Corporation;
- the Corporation s Annual Report to Shareholders for the year ended December 31, 2010; and
- Proxy Card.

You are cordially invited to attend the Annual Meeting. The giving of such proxy does not affect your right to vote in person at the Annual Meeting, if you give written notice to the Secretary of the Corporation of your intention to vote at the Annual Meeting.

By Order of the Board of Directors,

Richard A. Grafmyre

President and Chief Executive Officer

Dated: March 23, 2011

Important Notice Regarding Availability of Proxy Materials for the Annual Meeting of Shareholders to be held on Wednesday, April 27, 2011

The Proxy Statement and Annual Report to Shareholders for the year ended December 31, 2010 are available at http://www.cfpproxy.com/4823.

PENNS WOODS BANCORP, INC.
300 Market Street
Williamsport, PA 17701

PROXY STATEMENT FOR THE ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD WEDNESDAY, APRIL 27, 2011

Introduction, Date, Time, and Place of Annual Meeting

This Proxy Statement is being furnished in connection with the solicitation by the Board of Directors of PENNS WOODS BANCORP, INC. (the Corporation), a Pennsylvania business corporation, of proxies to be voted at the Annual Meeting (the Annual Meeting) of holders of Common Stock (the Common Stock) of the Corporation to be held on Wednesday, April 27, 2011, at 1:00 P.M., at the Holiday Inn Williamsport, 100 Pine Street, Williamsport, PA 17701, and any adjournment or postponement thereof.

The principal executive office of the Corporation is located at 300 Market Street, Williamsport, PA 17701. All inquiries should be directed to Richard A. Grafmyre, President of the Corporation, at (570) 322-1111. Jersey Shore State Bank (the Bank) is a wholly owned subsidiary of the Corporation.

Solicitation and Revocability of Proxies

This Proxy Statement and enclosed proxy card are first being sent to shareholders of the Corporation on or about March 23, 2011. Shares represented by the proxy, if properly signed and returned, will be voted in accordance with the specifications made thereon by the shareholders. Any proxy not specifying to the contrary will be voted FOR the Class 3 nominees noted, FOR the ratification of the appointment of S.R. Snodgrass, A.C., Certified Public Accountants, as the independent registered public accounting firm of the Corporation for the year ending December 31, 2011, FOR the non-binding vote on executive compensation, and FOR the frequency of the non-binding vote on executive compensation to be every two years. The execution and return of the enclosed proxy card will not affect the right of a shareholder of record to attend the Annual Meeting and to vote in person if such shareholder gives written notice to the Secretary of the Corporation. The cost of assembling, printing, mailing, and soliciting proxies and any additional material that the Corporation may furnish shareholders in connection with the Annual Meeting will be borne by the Corporation. In addition to the solicitation of proxies by use of the mails, directors, officers, and employees of the Corporation and/or the Bank may solicit proxies by telephone, telegraph, or personal interview, with nominal expense to the Corporation. The Corporation will also pay the standard charges and expenses of brokerage houses or other nominees or fiduciaries for forwarding proxy soliciting material to the beneficial owners of shares.

A shareholder of record who returns a proxy may revoke the proxy at any time before it is voted (1) by giving written notice of revocation to Richard A. Grafmyre, President and Chief Executive Officer, Penns Woods Bancorp, Inc., 300 Market Street, Williamsport, PA 17701, (2) by executing a later-dated proxy and giving written notice thereof to the Secretary of the Corporation, or (3) by voting in person after giving written notice to the President of the Corporation.

If your shares are held in street name (that is, through a broker, trustee or other holder of record), you will receive a proxy card from your broker seeking instructions as to how your shares should be voted. If no voting instructions are given, your broker or nominee has discretionary authority to vote your shares on your behalf on certain routine matters. A broker non-vote results on a matter when your broker or nominee returns a proxy but does not vote on a particular proposal because it does not have discretionary authority to vote on that proposal and has not received voting instructions from you. Under the rules of The New York Stock Exchange, only Proposal No. 2, the ratification of the appointment of the Corporation s independent registered public accounting firm, is a routine matter, and therefore, is the only proposal for which your broker or nominee has discretionary authority to vote. Your broker or nominee does not have discretionary authority to vote on Proposal No. 1, the election of the four Class 3 directors, Proposal No. 3, the non-binding vote on executive compensation, or Proposal No. 4, the non-binding vote on the frequency of future shareholder votes on executive compensation. You may not vote shares held in street name at the Annual Meeting unless you obtain a legal proxy from your broker or holder of record.

Quorum

Pursuant to the Bylaws of the Corporation, the presence, in person or by proxy, of shareholders entitled to cast at least a majority of the votes which all shareholders are entitled to cast will constitute a quorum for transaction of business at the Annual Meeting.

Voting Securities

Holders of record of the Common Stock at the close of business on March 1, 2011 will be entitled to notice of and to vote at the Annual Meeting. On March 1, 2011 there were 3,835,433 shares of Common Stock outstanding. Each share of the Common Stock outstanding as of the close of business on March 1, 2011, is entitled to one vote on each matter that comes before the meeting and holders do not have cumulative voting rights with respect to the election of directors.

Under Pennsylvania law and the Bylaws of the Corporation, the presence of a quorum is required for each matter to be acted upon at the Annual Meeting. Votes withheld, abstentions, and broker non-votes will be counted in determining the presence of a quorum for the particular matter.

Assuming the presence of a quorum, the four nominees for director receiving the highest number of votes cast by shareholders entitled to vote for the election of directors shall be elected. Votes withheld from a nominee and broker non-votes will not constitute or be counted as votes cast for such nominee.

Assuming the presence of a quorum, the affirmative vote of a majority of all votes cast by shareholders at the Annual Meeting is required for the ratification of the appointment of the Corporation s independent registered public accounting firm, for the approval of the non-binding vote on executive compensation, and in connection with the non-binding vote on the frequency of future shareholder votes on executive compensation. Abstentions will not constitute or be counted as votes cast, and therefore, will not affect the outcome of the vote on these matters.

All proxies properly executed and not revoked will be voted as specified.

THE BOARD OF DIRECTORS AND ITS COMMITTEES

The Corporation appointed the following standing committees for 2010:

		Number of Times Met During 2010
AUDIT:	James M. Furey, II, D. Michael Hawbaker, Leroy H. Keiler, III, R. Edward Nestlerode, Jr., James E. Plummer	4
EXECUTIVE:	Michael J. Casale, Jr., H. Thomas Davis, Jr., R. Edward Nestlerode, Jr., Hubert A. Valencik	0
The Bank appointed the following standing committees for 2010:		
AUDIT:	James M. Furey, II, D. Michael Hawbaker, Leroy H. Keiler, III, R. Edward Nestlerode, Jr., James E. Plummer	4
BUILDING & INSURANCE:	Michael J. Casale, Jr., H. Thomas Davis, Jr., James M. Furey, II, Leroy H. Keiler, III, Hubert A. Valencik	0
EXECUTIVE:	Michael J. Casale, Jr., H. Thomas Davis, Jr., James M. Furey, II, R. Edward Nestlerode, Jr., Hubert A. Valencik	0
COMPENSATION & BENEFITS:	Michael J. Casale, Jr., H. Thomas Davis, Jr., D. Michael Hawbaker, R. Edward Nestlerode, Jr., James E. Plummer	3
ASSET LIABILITY:	James M. Furey, II, D. Michael Hawbaker, Leroy H. Keiler, III, James E. Plummer, William H. Rockey, Hubert A. Valencik, Ronald A. Walko, Richard A. Grafmyre, Robert J. Glunk, Brian L. Knepp, Ann M. Riles, Janine E. Packer Mr. Glunk, Mr. Knepp, Mrs. Riles, and Mrs. Packer are employees of the Bank.	4

The Audit Committee is composed of five (5) independent directors within the meaning of the NASDAQ listing standards. The Audit Committee operates under a written charter, a copy of which is available on our website, www.jssb.com, under Investor Relations/ Financial Information/ Governance Documents and is available upon written request to the President. The Board of Directors has designated James E. Plummer as the Audit Committee financial expert. The Audit Committee is responsible for the appointment, compensation, oversight, and termination of the Corporation s independent auditors. The Audit Committee is required to pre-approve audit and certain non-audit services performed by the independent auditors. The Audit Committee also assists the Board of Directors in providing oversight over the integrity of the Corporation s financial statements, compliance with applicable legal and regulatory requirements and the performance of our internal audit function. The Audit Committee also is responsible for, among other things, reporting to the Board of Directors on the results of the annual audit and reviewing the financial statements and related financial and non-financial disclosures included in our Annual Report on Form 10-K and Quarterly Reports on Form 10-Q. Importantly, from a corporate governance perspective, the Audit Committee regularly evaluates the independent auditors independence, including approving consulting and other legally permitted, non-audit services provided by the auditors and the potential impact of the services on the auditors independence. The Audit Committee meets periodically with the independent auditors and the internal auditors outside of the presence of management, and possesses the authority to retain professionals to assist it in meeting its responsibilities without consulting with management. The Audit Committee reviews and discusses with management earnings releases, including the use of pro forma information. The Audit Committee also discusses with management and the independent auditors the effect of accounting initiatives. The Audit Committee also is responsible for receiving and retaining complaints and concerns relating to accounting and auditing matters.

The Board of Directors of the Corporation met twelve (12) times during 2010. The Board of Directors of the Bank met twenty-six (26) times during 2010. All of the Directors attended at least 75% of the aggregate of all meetings of the Board of Directors and the Committees of which they were members.

Board Leadership Structure

Our Board of Directors maintains the freedom to choose whether the roles of Chairman of the Board and Chief Executive Officer should be combined or separated, based on what it believes is best for the Corporation and its shareholders at any given time. Ronald A. Walko served as both Chairman of the Board and as President and Chief Executive Officer of the Corporation and the Bank until October 29, 2010, when the Corporation hired Richard A. Grafmyre to succeed Mr. Walko as President and Chief Executive Officer of the Corporation and the Bank. At that time, the Board of Directors determined that it would be appropriate to separate the roles of Chief Executive Officer and Chairman of the Board. Accordingly, Mr. Walko has continued to serve as Chairman of the Board of the Corporation and Bank. The Board of Directors believes that the current leadership structure, with Mr. Grafmyre as Chief Executive Officer, and Mr. Walko as Chairman of the Board, is the best leadership structure for the Corporation at this time, enabling Mr. Walko to apply his 25 years of service with the Bank and experience as President and Chief Executive Officer toward overseeing the Board of Directors and advising Mr. Grafmyre in his new role as Chief Executive Officer of the Corporation and Bank.

Board Risk Oversight

Each member of the Board of Directors has a responsibility to monitor and manage risks faced by the Corporation. At a minimum, this requires the members of the Board of Directors to be actively engaged in board discussions, review materials provided to them, and know when it is appropriate to request further information from management and/or engage the assistance of outside advisors. Furthermore, because the banking industry is highly regulated, certain risks to the Corporation are monitored by the Board of Directors through its review of the Corporation s and the Bank s compliance with regulations set forth by the banking regulatory authorities. Because risk oversight is a responsibility for each member of the Board of Directors, the Board s responsibility for risk oversight is not concentrated into a single committee. Instead, oversight is delegated, to a large degree, to the various board committees with an independent director serving in the capacity of committee chairman. These committees meet formally, as needed, to discuss risks and monitor specific areas of the Corporation s performance with their findings reported at the next scheduled full meeting of the Board of

Directors. In addition, the composition of the Board of Directors and normal agenda allow for the continuous oversight of risk by providing an environment which encourages the directors to ask specific questions or raise concerns and allots them sufficient time and materials to do so effectively. The overlap of committee membership provides a broad perspective of various risks and the actions undertaken to manage risks in today s environment.

Director Independence

In the view of the Board of Directors, all directors who are independent within the meaning of the NASDAQ listing standards should participate in the selection of director nominees. Accordingly, all directors, except for Messrs. Walko, Rockey, and Grafmyre, participate in the selection of director nominees. Directors who participate in the selection of director nominees operate under a written charter, a copy of which is available on our website, www.jssb.com, under Investor Relations/Financial Information/Governance Documents and is available upon request to the President. Independent directors considering the selection of director nominees will consider candidates recommended by shareholders. Shareholders desiring to submit a candidate for consideration as a nominee of the Board of Directors must submit the same information with regard to the candidate as that required to be included in the Corporation s proxy statement with respect to nominees of the Board of Directors in addition to any information required by the Bylaws of the Corporation. Shareholder recommendations should be submitted in writing to Penns Woods Bancorp, Inc., 300 Market Street, Williamsport, PA 17701 (Attention: President and Chief Executive Officer), on or before December 31 of the year preceding the year in which the shareholder desires the candidate to be considered as a nominee. Although the Board of Directors at this time does not utilize any specific written qualifications, guidelines or policies in connection with the selection of director nominees, candidates must have a general understanding of the financial services industry or otherwise be able to provide some form of benefit to the Corporation s business, possess the skills and capacity necessary to provide strategic direction to the Corporation, be willing to represent the interests of all shareholders, be able to work in a collegial board environment, and be available to devote the necessary time to the business of the Corporation. In addition to these requirements, candidates will be considered on the basis of diversity of experience, skills, qualifications, occupations, education, and backgrounds, and whether the candidate s skills and experience are complementary to the skills and experience of other Board members. Candidates recommended by shareholders will be evaluated on the same basis as candidates recommended by the independent directors.

Nominations for director to be made at the Annual Meeting by shareholders entitled to vote for the election of directors must be submitted to the Secretary of the Corporation not less than ninety (90) days or more than one hundred fifty (150) days prior to the Annual Meeting, which notice must contain certain information specified in the Bylaws. No notice of nomination for election as a director has been received from any shareholder as of the date of this Proxy Statement. If a nomination is attempted at the Annual Meeting that does not comply with the procedures required by the Bylaws or if any votes are cast at the Annual Meeting for any candidate not duly nominated, then such nomination and/or such votes may be disregarded.

COMPENSATION OF DIRECTORS

Director Compensation Table

Name	Fees Earned Or Paid In Cash ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(1)	All Other Compensation ($)	Total ($)
Michael J. Casale, Jr.	$ 33,700	$	$	$	$	$	$ 33,700

H. Thomas Davis, Jr.	34,600	34,600
James M. Furey, II		

Warranties and Product Liability

The Company warrants that its products conform to their respective functional specifications for periods that vary according to product category. The Company warrants its application software incorporated in its CIS and DIS products for one year after installation. The warranty periods may differ depending on the program that the products are sold under. However, customers may elect to enter into extended service agreements with the Company that further extends such

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warranties. The computers and other hardware components that the Company currently sells as part of its CIS and DIS products are subject to the warranties of their manufacturers. The manufacturers generally warrant their products against faulty material and workmanship for one to three years. The Company passes through the manufacturers warranties to the end users and in most cases contracts with the manufacturers who are to provide onsite warranty services through the manufacturer s service network. The Company s data acquisition products and components are warranted against faulty materials and workmanship for 90 days.

The Company currently carries an aggregate of $4,000,000 in product liability insurance. Management believes that this amount of insurance is adequate to cover its risks. To further mitigate its risks, the Company s standard hardware sales/software license agreement as well as its service agreement expressly limits its liabilities and the warranties of its products and services in accordance with accepted provisions of the Uniform Commercial code as adopted in most states.

Copyrights, Patents and Trade Secrets

The Company holds patents protecting some of its proprietary technology, which it has either filed directly or received through assignment. The Company has copyrighted the designs of its proprietary components and application software. Patent or copyright protection may not be available for many of the Company s products. A significant portion of the Company s proprietary technology is in the form of software. The Company has relied primarily on copyright and trade secret protection of its software. Management believes that its business is more dependent upon marketing, service, and knowledge than on patent or copyright protection. The Company has registered trademarks for CyberLAB CyberMED, CyberRAD, CyberPATH, CyberPRINT, CyberTERM, CyberLINK, CyberMATE, WebGateway, ImageWEB and MedVIEW, and has applied to register its trademarks on its other trade and company names. The Company has retained special intellectual property counsel to advise management on the appropriate course to follow with respect to these issues and has continued to pursue measures to protect its intellectual property.

Governmental Regulation

ASPYRA s products are subject to stringent government regulation in the United States and other countries. These laws and regulations govern product testing, manufacture, labeling, storage, record keeping, distribution, sale, marketing, advertising and promotion. The Company is also required to register as a medical device manufacturer with the Federal Drug Administration (FDA) and comply with FDA regulations. The regulatory process can be lengthy, expensive and uncertain, and securing clearances or approvals often requires the submission of extensive testing and other supporting information. If we do not comply with regulatory requirements, we may be subject to fines, recall or seizure of products, total or partial suspension of production, withdrawal of existing product approvals or clearances, refusal to approve or clear new applications or notices and criminal prosecution.

The Federal Food, Drug and Cosmetic Act, more commonly known for its regulation of drugs in interstate commerce, was amended by the Medical Device Amendments of 1976 (the Amendments) to cover devices used in medical practice. These include instruments and reagents used in biomedical laboratory testing. In 1987, the Federal Drug Administration (FDA) first classified a number of clinical software products as medical devices, but exempted most of them from routine regulations. Subsequently, the FDA amended the policy.

The Company is informed that the FDA requires most Class I and Class II medical devices, which include the Company s Clinical Information System and Picture Archive Communications System products, to comply with its Quality System Regulation (QSR). Additionally, the FDA requires all medical devices utilizing software to meet the design control requirements of the QSR. The Company completed an updated quality policy and a modification of its internal policies to comply with this directive. Management believes that the QSR procedures have an impact on its business to the extent that there are lengthened development cycles of new software and additional costs are incurred. However, all of its competitors are faced with the same requirements. The Company s Quality System will, however, allow for a higher level of customer satisfaction, as the internal processes and software must go through more rigorous audits and testing.

The FDA from time to time reevaluates its rules and classifications relevant to computer products used in connection with medical devices and software used in clinical applications. No assurance can be given that the Company s current or new products developed will not be subject to the provisions of the Amendments and implementing rules. From time to time the Company has retained special counsel to advise it in such matters. The likelihood of such changes and their effect on the business of the Company cannot be ascertained. If the FDA were to determine that additional provisions should apply to all or some of the Company s products, it is uncertain whether compliance with such interpretation would have a material adverse effect on the Company or its products or operations.

In general, the Company and its products are subject to direct governmental regulations applicable to manufacturers, including those regulations promulgated under the Occupational Safety and Health Act, and by the Environmental Protection Agency. The Company s customers, however, are subject to significant regulation by the FDA, the Centers for Medicare and

Medicaid Services, the Department of Health and Human Services , the Centers for Disease Control, and by state and local governmental authorities. Such regulations require the Company to comply with certain requirements in order to sell its systems, and are a major focus of its development efforts in order to maintain the regulatory compliance of its products. In addition, the new HIPAA requirements indirectly and directly are applicable to the Company and have been a focus of its new product development efforts during the last two fiscal years.

Backlog

The Company s backlog at December 31, 2006 was approximately $800,000 for software, hardware and interface products, and approximately $1,500,000 for deferred services, compared to approximately $1,200,000 for software, hardware and interface products, and $1,600,000 for deferred services, at December 31, 2005. The Company also has annually renewable extended service agreements under contracts aggregating in excess of $6,500,000.

Employees

At March 30, 2007, the Company had 99 full time and 2 part time employees of whom 26 are involved in product development, 16 in sales and marketing, 47 in technical services, training, and support, and 12 in administration. The Company is not subject to any collective bargaining agreements and considers its employee relations to be good.

Item 2. Description of Property.

ASPYRA s headquarters are located in a

leased facility in Calabasas, California. The facility was constructed in 1991 and comprises approximately 16,800 square feet with an effective base rental of approximately $24,537 per month, plus common area maintenance costs and property taxes. The facility is leased under an extension of the original lease that has a five year term that ends in October 2012 and is subject to cost of living adjustments in each year. All other provisions of the original lease substantially remained the same.

The Calabasas facility is used as general offices and operations headquarters that includes warehousing, service and support, training, development, and assembly. The Company considers the facility to be adequate for its intended purposes. The Company carries adequate general liability insurance, as required by the respective leases, to cover any risks concerning the facility.

ASPYRA also operates out of a leased facility in Jacksonville, Florida. The facility in Jacksonville was constructed in 1991 and comprises approximately 8,422 square feet with an effective base rental of approximately $11,405 per month, plus common area maintenance costs and property taxes. The Jacksonville location is leased under an extension of the original lease which has a five year term that ends in January 2012 and is subject to cost of living adjustments in each year.

The Jacksonville facilities are used as general offices and for operations that includes service and support, training, development, and product integration. The Company carries adequate general liability insurance, as required by its respective leases, to cover any risks concerning the facilities.

ASPYRA s United Kingdom subsidiary Aspyra Technologies, Ltd. is located in East Grinstead, West Sussex, United Kingdom. In June 2005, a new lease was entered into for 3 years with the option to terminate after two years. The combined space in the United Kingdom office is 640 square feet with a monthly rent of $3,366. The facilities are used for general offices.

Item 3. Legal Proceedings.

There are no material active, pending, or threatened legal proceedings to which the Company is a party.

From time to time we may be involved in other litigation relating to claims of alleged infringement, misuse or misappropriation of intellectual property rights of third parties. We may also be subject to claims arising out of our operations in the normal course of business. As of the date of this Form 10-KSB, we are not a party to any such other litigation that would have a material adverse effect on us or our business.

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

The Company did not submit any matter to a vote of its security holders during the fourth quarter of its fiscal year ended December 31, 2006.

PART II

Item 5. Market for Common Equity, Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities.

(a) Market information.

The Company s common shares trade publicly on the American Stock Exchange under the symbol APY . The following table sets forth for the periods indicated, the range of the high and low sale prices for the common shares as reported by the American Stock Exchange. The prices do not include retail markups, markdowns, or commissions.

	High	Low
Fiscal 2005 ending December 31,		
First Quarter	$ 3.98	$ 1.85
Second Quarter	2.35	1.69
Third Quarter	2.90	1.68
Fourth Quarter	3.00	2.10
Fiscal 2006 ending December 31,		
First Quarter	2.75	2.05
Second Quarter	2.55	1.35
Third Quarter	2.45	1.62
Fourth Quarter	2.25	1.50

(b) Holders.

The number of shareholders of record of Common Shares of the Company as of March 30, 2007 was approximately 550. The Company also has approximately 900 beneficial holders of record whose shares are held in street name as of March 30, 2007.

(c) Dividends.

Holders of Common Shares are entitled to receive such dividends as may be declared by the Company s Board of Directors. The Company has never paid a cash dividend on its Common Shares and the Board of Directors currently intends to retain any earnings for use in the Company s business.

(d) Securities authorized for issuance under equity compensation plans.

The following table represents securities authorized for issuance under our equity compensation plans as of December 31, 2006:

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of options, warrants and rights	Weighted-average exercise price of outstanding options, warrants, and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column)
Equity Compensation Plans approved by security holders	1,290,875	$ 2.45	820,227
Equity Compensation Plans not approved by security holders	0		0
Total			

(e) Recent sales of unregistered securities.

From time to time the Company has issued restricted common shares to its employees in lieu of compensation for vacation pay. However, there were no such issuances of unregistered Common Shares during the years ended December 31, 2006 and 2005.

(f) Small business issuer purchase of equity securities.

During the years ended December 31, 2006 and 2005, there were no repurchases of Common Shares.

Item 6. Management s Discussions and Analysis or Plan of Operation.

Overview

The following discussion relates to the merged business of ASPYRA, which includes the operations of its wholly owned subsidiary Aspyra Diagnostic Solutions, Inc. (ADSI) formerly StorCOMM, Inc. and its wholly owned subsidiary Aspyra Technologies, Ltd. (ATI) formerly StorCOMM Technologies, Ltd.. The merger, which resulted in the acquisition of ADSI, was consummated on November 22, 2005 and this is the first full annual report since the merger was consummated.

ASPYRA operates in one business segment determined in accordance with Statement of Financial Accounting Standards (SFAS) No. 131, and generates revenues primarily from the sale of its Clinical and Diagnostic Information Systems, which includes the license of proprietary application software, and may include the sale of servers and other hardware components to be integrated with its application software. In connection with its sales of its products, the Company provides implementation services for the installation, integration, and training of end users personnel. The Company also generates sales of ancillary software and hardware, to its customers and to third parties. We recognize these revenues under system sales in our financial statements. The Company also generates recurring revenues from the provision of comprehensive post implementation services to its customers, pursuant to extended service agreements. We recognize these revenues under service revenues in our financial statements. This service relationship is an important aspect of our business as the Company s products are mission critical systems that are used by healthcare providers in most cases 24 hours per day and 7 days per week. The ability to provide comprehensive services is crucial to obtaining new customers and maintaining existing customers. In order to retain this service relationship we must keep our products current for competitive, clinical, diagnostic, and regulatory compliance. Enhancements to our products in the form of software upgrades are an integral part of our business model and are included as a contract obligation in our warranty and extended service agreements. In order to generate such revenue opportunities our investment in software enhancements is significant and is a key component of our on going support obligations.

Because of the nature of our business, ASPYRA makes significant investments in research and development for new products and enhancements to existing products. Historically, ASPYRA has funded its research and development programs through cash flow primarily generated from operations. Management anticipates that future expenditures in research and development will either continue at current levels or may increase for the foreseeable future, and will be funded primarily out of the Company s cash flow from operations.

ASPYRA s results of operation for the fiscal year ended December 31, 2006 were marked by an increase in sales and an operating loss that are more fully discussed in the following section Results of Operations. The Company s increase in revenues was due to the addition of the revenues from ASPYRA s wholly owned subsidiary ADSI. Aspyra s operating loss was attributable to two primary factors, the Company experienced volatility in sales quarter to quarter due to the Company s reliance on third party distributors for its PACS products which attributed to its operating loss. Second, the Company underwent significant integration activities which were costly and time consuming.

Generally, sales cycles for CIS and DIS products are lengthy and on average exceed six months from inception to closure. Because of the complexity of the sales process, a number of factors that are beyond the control of the Company can delay the closing of transactions. Furthermore, the Company has been primarily reliant on distributors and channel partners for the sales of its diagnostic systems and has been subject to inconsistencies in the performance of such third parties and the

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timely consummation of orders. ASPYRA completed a unification of its sales force to focus more on a direct sales model for some of the diagnostic system products to supplement the distribution and channel network so that it is less reliant on third parties in the sale of its diagnostic systems. ASPYRA also has completed new versions of its laboratory and radiology information systems products, as well as its new AccessRAD Radiology Information System (RIS) / Picture Archive Communication Systems (PACS) which it has begun marketing and anticipates increased sales related to such new product releases in the future.

The operating losses incurred by the Company during the fiscal year ended December 31, 2006 were also attributable to the costs associated with integration activities in addition to the uneven sales performance previously discussed. The Company completed the integration and restructuring of the merged businesses and incurred certain costs associated with such activities which were only partially offset by reductions in redundant personnel and other expenses during the 2006 fiscal year. The Company expects to achieve synergies and cost reductions in its business as it completes further integration and restructuring through the first half of fiscal 2007. In sum approximately $1.9 million in non recurring expenses were incurred during the 2006 fiscal year as a result of the integration and restructure of the merged business.

ASPYRA concluded the merger on November 22, 2005 and has accounted for the transaction as a purchase. Accordingly only the operations of ADSI for the period beginning November 23, 2005 through December 31, 2005 have been consolidated in the audited financial statements for the fiscal year ended December 31, 2005. However the operations for the entire Company are included in the results of operations for the fiscal year ended December 31, 2006. In addition, ASPYRA elected to change its fiscal year end from August 31 to December 31 in January 2005 and filed a transitional report on Form 10-QSB for the four months ended December 31, 2004.

This management s discussion and analysis compares the results of operation for the fiscal year ended December 31, 2006 with the fiscal year ended December 31, 2005.

Results of Operations

Year Ended December 31, 2006 Compared to Year Ended December31, 2005

The following table sets forth certain line items in our condensed consolidated statement of operations as a percentage of total revenues for the periods indicated:

	Fiscal Year Ended December 31, 2006		**Fiscal Year Ended December 31, 2005**	
Revenues:				
System sales	44.6	%	29.3	%
Service revenues	55.4		70.7	
Total revenues	100.0		100.0	
Cost of products and services sold:				
System sales	30.8		25.2	
Service revenues	22.8		26.1	
Total cost of products and services	53.6		51.3	
Gross profit	46.4		48.7	
Operating expenses:				
Selling, general and administrative	57.1		54.0	
Research and development	15.6		18.0	
Total operating expenses	72.7		72.0	
Operating loss	(26.3	)	(23.3	)
Loss before provision for income taxes	(28.1	)	(23.5	)
Provision for income taxes			(11.2	)
Net loss	(28.1	)	(34.7	)

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Revenues

Sales for the fiscal year ending December 31, 2006 were $12,689,217, as compared to $7,205,757 for the fiscal year ending December 31, 2005, an overall increase of $5,483,460 or 76.1%. When analyzed by revenue category, sales of Clinical Information Systems (CIS) and Diagnostic Information Systems (DIS) increased by $3,552,847 or 168.2%, and services increased by $1,931,013 or 37.9%. The increase in sales of CIS and DIS products during the current period was positively affected by the consolidation of the reporting of the former entities results of operation for the full fiscal year. In addition, the Company has invested additional funds into marketing activities to rebuild its CIS sales pipeline, which was beginning to show improvement by the end of the 2006 fiscal year. Secondly, the DIS products have been sold through distributors and channel partners since the inception of ADSI s business and accounted for approximately 90% of the sales in fiscal year ended December 31, 2005. Shortly after the merger with ADSI was consummated, its primary distributor announced that it had changed ownership and subsequently went through a management and operational restructure, which temporarily caused a cessation in new order flow. Although the distributor has since resumed representation, new order flow is not at the historical levels and management is developing other sources of lead generation. As part of its future growth strategy management is emphasizing direct sales activities of its DIS products while it continues to utilize distributors and channel partners for some products and market sectors.

The increase in service revenues is attributable to a greater number of customer accounts under contract. As part of the assets acquired in the merger, ASPYRA gained the service relationship with ADSI s customers and continues to integrate all of its service policies, procedures and operational activities including the utilization of ASPYRA s customer relationship management system throughout the Company. At present, the Company has approximately $6.5 million in annual renewable service agreements under contract and also has some customers that it supports under billable arrangements. Service revenues are expected to continue to increase as the Company s installed base of CIS and DIS installations increases.

The Company continues to expand its sales and marketing activities, directing its focus towards larger customers and multi-product sales as well as selling new products into its installed customer base. The Company continues to seek strategic joint marketing partnerships with other companies, and channel partners, which has improved the Company s market penetration and has initiated more marketing activities internationally. ASPYRA s pipeline of working CIS and DIS transactions continues to improve, and management views the near term outlook for the continued sale of such products as cautiously optimistic during the first half of the 2007 fiscal year. The Company s future operating results will continue to be subject to annual and quarterly variations based upon a wide variety of factors, including the volume mix and timing of orders received during any quarter or annual period. In addition, the Company s revenues associated with CIS and DIS transactions may be delayed due to customer related issues such as availability of funding, staff availability, IT infrastructure readiness, and the performance of third party contractors, all of which are issues outside of the control of ASPYRA.

Cost of Products and Services Sold

Cost of products and services sold overall increased by $3,109,500 or 84.1% for the fiscal year ended December 31, 2006 as compared to the fiscal year ended December 31, 2005. The overall increase in cost of sales was primarily attributable to an increase in labor costs of $1,047,003 or 51.6%, an increase of $1,187,436 or 296.6% in material costs, and an increase in other costs of sales of $875,061 or 69.2%. The increase in labor costs and other costs of sales was primarily attributable to additional personnel hired during the fiscal year and the absorption of the former ADSI operations department into ASPYRA following the merger. The increase in material costs was attributable to a higher volume of transactions that included hardware components that were provided in connection with sales of DIS products. On a going forward basis sales of DIS products are expected to include a higher percentage of hardware components as the average sale of a typical PACS system includes specialized viewers, storage devices and other hardware components that are specifically configured for the system and required for optimum operation. The increase in other costs of sales was attributable to the absorption of overhead including the Jacksonville and UK facilities and infrastructure.

Cost of sales as a percentage of sales increased to 54% for the fiscal year ended December 31, 2006, as compared to 51% for the fiscal year ended December 31, 2005. The overall percentage increase in cost of sales, as a percentage of sales, was primarily attributable to the absorption of the former ADSI operations departments into ASPYRA and the volume and mix of sales. Management believes the gross profit margin will improve in fiscal 2007 for the full year of operations; however, the Company could experience quarterly variations in gross margin as a result of the factors discussed above. Management was able to eliminate redundant personnel and achieve operational synergies that yielded reductions in operating expenses during fiscal 2006 which we expect to be evident in 2007.

Selling, General and Administrative Expenses

Selling, general, and administrative expenses increased in aggregate by $3,353,738 or 86.2% for the fiscal year ended December 31, 2006 as compared to the fiscal year ended December 31, 2005. Of the total increase, approximately $678,000 was attributable to expenses incurred by ASPYRA and the balance of approximately $2,676,000 is attributable to the expenses of ADSI absorbed post merger and was primarily attributable to the personnel and overhead expenses associated with the sales, general and administrative departments. The approximately $678,000 increase incurred by ASPYRA consisted of approximately $617,000 of increases in general and administrative expenses and approximately $61,000 in increases in selling and marketing expenses. The increases in general and administrative expenses were primarily attributable to additional expenditures for legal and auditing of about $232,000, expenses associated with corporate governance of $142,000 including filing fees, board of director expenses, and investor relations, depreciation expense of about $67,000, section 123R expenses associated with stock options of about $87,000, and various other expenses of about $89,000 in aggregate that were partially offset by savings in other expense categories . The increases in selling and marketing expenses of approximately $61,000 were primarily attributable to a user symposium of about $45,000 and tradeshow expenses of about $16,000. The increased trade show expenses were primarily attributable to the launch of the merged Company and new products. A significant portion of the overall increased expenses was merger related and nonrecurring.

The Company plans to continue to make investments in sales and marketing programs in fiscal 2007 associated with increased activities related to programs that target sales opportunities in the community hospital and multi-specialty clinic sectors. During fiscal 2007, the Company plans to complete the implementation of its new customer relationship management system and accounting systems throughout the ADSI operation and expects to incur expenses associated with that implementation; a portion of such costs will be expensed. However we also expect to reduce certain personnel expense as the systems implementations will provide for additional synergies.

Research and Development Expenses

Research and development expenses increased $680,704 or 52.3% during the fiscal year ended December 31, 2006, as compared to the fiscal year ended December 31, 2005. Of this amount approximately $157,000 was attributable to increased expenses incurred by ASPYRA, and the balance of approximately $524,000 represents the expenses absorbed related to ADSI post merger which was primarily attributable to development personnel and attendant overhead of the research and development department. The increase of $157,000 attributable to ASPYRA is associated with increases in salaries and expenses of new personnel in product development added during the period. Such increased expenses were attributable to the development of AccessRAD, enhancements and new modules for the Company s CIS products, and new applications under development. For its current fiscal year ended December 31, 2006 and fiscal year ended December 31, 2005, the Company capitalized software costs of $930,810 and $687,738, respectively, which are generally amortized over the estimated useful life not to exceed five years. Management anticipates its overall research and development activities to remain fairly constant in fiscal 2007.

Interest and other income was $99,962 for the fiscal year ended December 31, 2006 as compared to $26,461 for the fiscal year ended December 31, 2005 due to increased interest earned on money market deposits, and an increase in finance charges levied on customers who were late in their payments on accounts receivable.

Interest and other expense was $321,679 for the fiscal year ended December 31, 2006 as compared to $37,934 for the fiscal year ended December 31, 2005. Of this amount approximately $192,000 was associated with a penalty imposed as a result of a delay in the registration of the securities underlying the private equity placements. The balance was primarily attributable to an increased level of borrowings on the Company s line of credit with its bank and interest expense on the debt assumed post merger.

Income tax provision was $4,810 for the fiscal year ended December 31, 2006 as compared to $807,013 for the fiscal year ended December 31, 2005. The decrease was primarily a result of the Company recording an additional valuation allowance of $793,877 in the third quarter of fiscal year ended December 31, 2005 and during 2006, maintaining the full valuation allowance.

As a result of the factors discussed above, the Company had a net loss of $3,570,438 for the fiscal year ended December 31, 2006, compared to a net loss of $2,501,915 for the fiscal year ended December 31, 2005. The Company s basic and diluted loss per share was $0.36 for fiscal year ended December 31, 2006 as compared to basic and diluted loss per share of $0.62 in fiscal year ended December 31, 2005.