

FARMERS NATIONAL BANC CORP /OH/

Form 10-Q

May 09, 2007

**Table of Contents**

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

**Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarter ended March 31, 2007**

**Commission file number 0-12055  
FARMERS NATIONAL BANC CORP.  
(Exact name of registrant as specified in its charter)**

OHIO

34-1371693

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No)

20 South Broad Street  
Canfield, OH 44406

44406

(Address of principal executive offices)

(Zip Code)

(330) 533-3341

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

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.

Class

Outstanding at April 30, 2007

Common Stock, No Par Value

13,067,182 shares

**PART I FINANCIAL INFORMATION**

Item 1	Financial Statements	
	Included in Part I of this report:	
	Farmers National Banc Corp. and Subsidiary	
	Consolidated Balance Sheets	1
	Consolidates Statements of Income and Comprehensive Income	2
	Condensed Consolidated Statements of Cash Flows	3
	Notes to Unaudited Consolidated Financial Statements	4-7
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	7-12
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	13
<u>Item 4</u>	<u>Controls and Procedures</u>	13

**PART II OTHER INFORMATION**

<u>Item 1</u>	<u>Legal Proceedings</u>	13
<u>Item 1A</u>	<u>Risk Factors</u>	13
<u>Item 2</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	14
<u>Item 3</u>	<u>Defaults Upon Senior Securities</u>	14
<u>Item 4</u>	<u>Submission of Matters to a Vote of Security Holders</u>	14
<u>Item 5</u>	<u>Other Information</u>	14
<u>Item 6</u>	<u>Exhibits</u>	15

**SIGNATURES**

<b>10-Q Certifications</b>	17-18
<b>Section 906 Certifications</b>	19-20
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	

EX-32.2

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**Table of Contents**

**CONSOLIDATED BALANCE SHEETS**  
**FARMERS NATIONAL BANC CORP. AND SUBSIDIARY**  
**(Unaudited)**

	(In Thousands of Dollars)	
	<b>March 31, 2007</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 26,664	\$ 24,447
Federal funds sold	106	9,591
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<b>26,770</b>	<b>34,038</b>
Securities available for sale	245,894	255,799
Loans	507,088	508,188
Less allowance for loan losses	5,556	5,594
<b>NET LOANS</b>	<b>501,532</b>	<b>502,594</b>
Premises and equipment, net	14,593	14,744
Other assets	14,491	14,409
<b>TOTAL ASSETS</b>	<b>\$ 803,280</b>	<b>\$ 821,584</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Deposits:		
Noninterest-bearing	\$ 59,056	\$ 66,003
Interest-bearing	537,912	553,744
<b>TOTAL DEPOSITS</b>	<b>596,968</b>	<b>619,747</b>
Short-term borrowings	79,171	77,792
Long-term borrowings	46,725	41,601
Other liabilities	4,294	6,221
<b>TOTAL LIABILITIES</b>	<b>727,158</b>	<b>745,361</b>
Commitments and contingent liabilities		
Stockholders Equity:		
Common Stock Authorized 25,000,000 shares; issued 14,654,727 in 2007 and 14,567,280 in 2006	89,288	88,366

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Retained earnings	9,340	9,617
Accumulated other comprehensive income (loss)	(1,187)	(1,345)
Treasury stock, at cost; 1,580,045 shares in 2007 and 1,494,525 in 2006	(21,319)	(20,415)
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>76,122</b>	<b>76,223</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 803,280</b>	<b>\$ 821,584</b>

See accompanying notes

1

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**Table of Contents**

**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**  
**FARMERS NATIONAL BANC CORP. AND SUBSIDIARY**  
**(Unaudited)**

	(In Thousands except Per Share Data)	
	For the Three Months Ended	
	<b>March 31,</b>	<b>March 31,</b>
	<b>2007</b>	<b>2006</b>
<b>INTEREST AND DIVIDEND INCOME</b>		
Loans, including fees	\$ 8,365	\$ 8,023
Taxable securities	1,852	1,874
Tax exempt securities	682	587
Dividends	144	110
Federal funds sold	28	42
<b>TOTAL INTEREST AND DIVIDEND INCOME</b>	<b>11,071</b>	<b>10,636</b>
<b>INTEREST EXPENSE</b>		
Deposits	4,129	3,428
Short-term borrowings	647	523
Long-term borrowings	578	531
<b>TOTAL INTEREST EXPENSE</b>	<b>5,354</b>	<b>4,482</b>
<b>NET INTEREST INCOME</b>	<b>5,717</b>	<b>6,154</b>
Provision for loan losses	60	110
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>5,657</b>	<b>6,044</b>
<b>NONINTEREST INCOME</b>		
Service charges on deposit accounts	680	683
Security gains	552	257
Other operating income	365	353
<b>TOTAL NONINTEREST INCOME</b>	<b>1,597</b>	<b>1,293</b>
<b>NONINTEREST EXPENSES</b>		
Salaries and employee benefits	2,938	2,792
Occupancy and equipment	677	646
State and local taxes	227	225
Professional fees	147	127
Loan expenses	77	95
Other operating expenses	1,052	878

TOTAL NONINTEREST EXPENSES	5,118	4,763
INCOME BEFORE INCOME TAXES	2,136	2,574
<b>INCOME TAXES</b>	327	612
NET INCOME	\$ 1,809	\$ 1,962
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:</b>		
Change in net unrealized gains (losses) on securities, net of reclassifications	158	(4)
COMPREHENSIVE INCOME	\$ 1,967	\$ 1,958
<b>NET INCOME PER SHARE-basic and diluted</b>	\$ 0.14	\$ 0.15
<b>DIVIDENDS PER SHARE</b>	\$ 0.16	\$ 0.16

See accompanying notes

2

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**Table of Contents**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FARMERS NATIONAL BANC CORP. AND SUBSIDIARY**  
**(Unaudited)**

	(In Thousands except Per Share Data)	
	Three Months Ended	
	<b>March 31, 2007</b>	<b>March 31, 2006</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 1,809	\$ 1,962
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	60	110
Depreciation and amortization	321	270
Net amortization of securities	109	215
Security gains	(552 )	(257)
Federal Home Loan Bank dividends	0	(56)
Net change in other assets and liabilities	(2,203 )	622
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>(456 )</b>	<b>2,866</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from maturities and repayments of securities available for sale	12,409	11,847
Proceeds from sales of securities available for sale	2,710	1,696
Purchases of securities available for sale	(4,529 )	(787)
Loan originations and payments, net	1,002	327
Additions to premises and equipment	(60 )	(33)
<b>NET CASH FROM INVESTING ACTIVITIES</b>	<b>11,532</b>	<b>13,050</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net change in deposits	(22,779 )	(11,605)
Net change in short-term borrowings	1,379	(3,360)
Proceeds from Federal Home Loan Bank borrowings and other debt	10,000	10,000
Repayment of Federal Home Loan Bank borrowings and other debt	(4,876 )	(1,313)
Repurchase of common stock	(904 )	(1,578)
Cash dividends paid	(2,086 )	(2,037)
Proceeds from dividend reinvestment	922	992
<b>NET CASH FROM FINANCING ACTIVITIES</b>	<b>(18,344 )</b>	<b>(8,901)</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(7,268 )</b>	<b>7,015</b>
Beginning cash and cash equivalents	34,038	31,614
Ending cash and cash equivalents	\$ 26,770	\$ 38,629

Supplemental cash flow information:

Interest paid		\$ 5,556	\$ 4,245
	See accompanying notes		
	3		

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**Table of Contents**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**Principles of Consolidation:**

The consolidated financial statements include the accounts of the company and its wholly-owned subsidiary, The Farmers National Bank of Canfield. All significant intercompany balances and transactions have been eliminated.

**Basis of Presentation:**

The unaudited condensed consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ( U.S. GAAP ) for complete financial statements. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2006 Annual Report to Shareholders included in the Company's 2006 Annual Report on Form 10-K. The interim condensed consolidated financial statements include all adjustments (consisting of only normal recurring items) that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year.

**Estimates:**

To prepare financial statements in conformity with U.S. GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses is particularly subject to change.

**Segments:**

The Company provides a broad range of financial services to individuals and companies in northeastern Ohio. While the Company's chief decision makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all the Company's banking operations are considered by management to be aggregated in one reportable operating segment.

**Table of Contents****Securities:**

Securities available for sale at March 31, 2007 and December 31, 2006 are summarized as follows:

(In Thousands of Dollars)	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
<b>March 31, 2007</b>			
U.S. Treasury and U.S. Government sponsored enterprises	\$ 73,056	\$ 123	\$ (669)
Mortgage-backed securities	97,790	66	(2,286)
Obligations of states and political subdivisions	70,090	322	(439)
Total debt securities	240,936	511	(3,394)
Equity securities	4,958	1,056	0
<b>TOTALS</b>	<b>\$ 245,894</b>	<b>\$ 1,567</b>	<b>\$ (3,394)</b>

(In Thousands of Dollars)	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
<b>December 31, 2006</b>			
U.S. Treasury and U.S. Government sponsored enterprises	\$ 75,931	\$ 105	\$ (843)
Corporate debt securities	1,000	0	(1)
Mortgage-backed securities	102,586	72	(2,610)
Obligations of states and political subdivisions	68,967	296	(345)
Total debt securities	248,484	473	(3,799)
Equity securities	7,315	1,257	0
<b>TOTALS</b>	<b>\$ 255,799</b>	<b>\$ 1,730</b>	<b>\$ (3,799)</b>

Unrealized losses on debt securities issued by the U.S. Treasury, U.S. Government agencies, or U.S. Government sponsored enterprises and obligations of state and political subdivisions have not been recognized into income because the securities are of high credit quality, management has the intent and ability to hold these securities for the foreseeable future and the decline in fair value is largely due to increases in market interest rates. The fair value is expected to recover as the securities approach their maturity date. Unrealized losses on mortgage-backed securities have not been recognized into income because these securities are backed by performing assets, timely repayment of principal and interest on these securities is guaranteed by the issuer, and because management has the intent and ability to hold these securities for the foreseeable future. The fair value of these securities is expected to recover as principal payments are received.

**Table of Contents****Earnings Per Share:**

The computation of basic and diluted earnings per share is shown in the following table:

(In Thousands, except Per Share Data)	Three months ended March 31,	
	2007	2006
<b>Basic EPS computation</b>		
Numerator Net income	\$ 1,809	\$ 1,962
Denominator Weighted average shares outstanding	13,048,716	12,985,336
<b>Basic earnings per share</b>	\$ .14	\$ .15
<b>Diluted EPS computation</b>		
Numerator Net income	\$ 1,809	\$ 1,962
Denominator Weighted average shares outstanding for basic earnings per share	13,048,716	12,985,336
Effect of Stock Options	0	4,125
Weighted averages shares for diluted earnings per share	13,048,716	12,989,461
<b>Diluted earnings per share</b>	\$ .14	\$ .15

For the quarter ended March 31, 2007, 48,000 shares were not considered in the dilutive earnings per share calculation because they were not dilutive.

**Comprehensive Income:**

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income consists solely of the change in unrealized gains and losses on securities available for sale, net of reclassification for gains recognized in income.

**Recent Accounting Pronouncements**

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. The Company has not completed its evaluation of the impact of the adoption of this standard.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), which prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company has determined that the adoption of FIN 48 did not have a material effect on the financial statements.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. This issue requires that a liability be recorded during the service period

**Table of Contents**

when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. This issue is effective for fiscal years beginning after December 15, 2007. The Company has not completed its evaluation of the impact of adoption of EITF 06-4.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 gives entities the option to measure eligible financial assets and financial liabilities at fair value on an instrument by instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be reported in earnings. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Management does not expect that the adoption of this standard on January 1, 2008 will have a material impact on the Corporation's financial statements.

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

When used in this Form 10-Q, or in future filings with the Securities and Exchange Commission, in press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," similar expressions are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the Corporation's actual results to be materially different from those indicated. Such statements are subject to certain risks and uncertainties including changes in economic conditions in the market areas the Corporation conducts business, which could materially impact credit quality trends, changes in policies by regulatory agencies, fluctuations in interest rates, demand for loans in the market areas the Corporation conducts business, and competition, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Corporation wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Corporation undertakes no obligation to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

**Table of Contents****Results of Operations**

Comparison of selected financial ratios and other results for the three-month period ending March 31, 2007:

(In Thousands, except Per Share Data)	Three months ended	
	March 31,	
	2007	2006
Total Assets	\$ 803,280	\$ 820,965
Net Income	\$ 1,809	\$ 1,962
Basic and Diluted Earnings Per Share	\$ .14	\$ .15
Return on Average Assets (Annualized)	.91%	.97%
Return on Average Equity (Annualized)	9.70%	10.46%
Efficiency Ratio (Year-to-date)	75.69%	66.24%
Capital to Asset Ratio	9.48%	9.16%
Dividends to Net Income (Year-to-date)	115.31%	105.56%
Loans to Assets	63.13%	62.27%
Net Loans to Deposits	84.01%	81.62%

Net Interest Income. The following schedule details the various components of net interest income for the periods indicated. All asset yields are calculated on a tax-equivalent basis where applicable. Security yields are based on amortized cost.

**Table of Contents****Average Balance Sheets and Related Yields and Rates**

(Dollar Amounts in Thousands)

	Three Months Ended March 31, 2007			Three Months Ended March 31, 2006		
	AVERAGE		RATE (1)	AVERAGE		RATE (1)
	BALANCE	INTEREST		BALANCE	INTEREST	
<b>EARNING ASSETS</b>						
Loans (3) (4) (5)	\$ 504,433	\$ 8,454	6.80%	\$ 510,146	\$ 8,105	6.44%
Taxable securities	178,476	1,852	4.21	191,450	1,875	3.97
Tax-exempt securities (5)	69,983	1,026	5.95	59,396	883	6.03
Equity Securities (2) (5)	10,315	164	6.45	12,252	122	4.04
Federal funds sold	2,117	28	5.36	3,784	42	4.50
Total earning assets	765,324	11,524	6.11	777,028	11,027	5.76
<b>NON-EARNING ASSETS</b>						
Cash and due from banks	22,416			25,488		
Premises and equipment	14,710			15,067		
Allowance for Loan Losses	(5,585)			(5,871)		
Other assets (3)	9,370			8,216		
Total Assets	\$ 806,235			\$ 819,928		
<b>INTEREST-BEARING LIABILITIES</b>						
Time deposits	\$ 273,082	\$ 3,075	4.57%	\$ 286,107	\$ 2,641	3.74%
Savings deposits	175,259	915	2.12	154,262	519	1.36
Demand deposits	97,961	139	0.58	124,333	268	0.87
Repurchase agreements	70,112	625	3.62	68,700	507	2.99
Borrowings	50,089	600	4.86	48,827	547	4.54