

FARMERS NATIONAL BANC CORP /OH/

Form 10-Q

November 08, 2006

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**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 September 30, 2006**

**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
Common Stock, No Par Value

Outstanding at October 31, 2006
13,036,262 shares

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Included in Part I of this report:

Farmers National Banc Corp. and Subsidiary

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

	(In Thousands of Dollars)	
	September 30, 2006	December 31, 2005
ASSETS		
Cash and due from banks	\$ 23,646	\$ 31,614
Federal funds sold	11,267	0
TOTAL CASH AND CASH EQUIVALENTS	34,913	31,614
Securities available for sale	243,164	259,485
Loans	511,597	511,914
Less allowance for loan losses	5,845	5,860
NET LOANS	505,752	506,054
Premises and equipment, net	14,845	15,143
Other assets	18,017	14,773
TOTAL ASSETS	\$ 816,691	\$ 827,069
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Noninterest-bearing	\$ 57,927	\$ 61,896
Interest-bearing	546,564	568,904
TOTAL DEPOSITS	604,491	630,800
Short-term borrowings	85,371	73,313
Long-term borrowings	42,856	43,158
Other liabilities	7,400	3,934
TOTAL LIABILITIES	740,118	751,205
Commitments and contingent liabilities		
Stockholders Equity:	87,434	84,595

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Common Stock	Authorized 25,000,000 shares; issued 14,479,768 in 2006 and 14,227,538 in 2005		
Retained earnings		10,083	10,709
Accumulated other comprehensive income (loss)		(1,581)	(2,536)
Treasury stock, at cost; 1,396,006 shares in 2006 and 1,184,315 in 2005		(19,363)	(16,904)
	TOTAL STOCKHOLDERS EQUITY	76,573	75,864
	TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 816,691	\$ 827,069

See accompanying notes

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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		For the Nine Months Ended	
	Sept. 30, 2006	Sept. 30, 2005	Sept. 30, 2006	Sept. 30, 2005
INTEREST AND DIVIDEND INCOME				
Loans, including fees	\$ 8,438	\$ 8,076	\$ 24,658	\$ 23,320
Taxable securities	1,862	2,004	5,620	6,263
Tax exempt securities	632	560	1,831	1,544
Dividends	168	101	446	312
Federal funds sold	71	77	278	196
TOTAL INTEREST AND DIVIDEND INCOME	11,171	10,818	32,833	31,635
INTEREST EXPENSE				
Deposits	4,013	3,018	11,232	8,497
Short-term borrowings	738	527	1,929	1,231
Long-term borrowings	504	440	1,563	1,267
TOTAL INTEREST EXPENSE	5,255	3,985	14,724	10,995
NET INTEREST INCOME	5,916	6,833	18,109	20,640
Provision for loan losses	30	260	200	529
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,886	6,573	17,909	20,111
NONINTEREST INCOME				
Service charges on deposit accounts	802	756	2,244	2,040
Security gains	122	105	517	290
Other operating income	412	327	1,199	993
TOTAL NONINTEREST INCOME	1,336	1,188	3,960	3,323
NONINTEREST EXPENSES				
Salaries and employee benefits	2,992	2,909	8,659	8,747
Occupancy and equipment	627	657	1,868	2,022
State and local taxes	222	227	672	689
Loan expenses	103	116	302	304
Other operating expenses	1,073	1,157	3,168	3,349

TOTAL NONINTEREST EXPENSES	5,017	5,066	14,669	15,111
INCOME BEFORE INCOME TAXES	2,205	2,695	7,200	8,323
INCOME TAXES	454	667	1,599	2,126
NET INCOME	\$ 1,751	\$ 2,028	\$ 5,601	\$ 6,197
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Change in net unrealized gains (losses) on securities, net of reclassifications	3,124	(1,338)	955	(2,258)
COMPREHENSIVE INCOME	\$ 4,875	\$ 690	\$ 6,556	\$ 3,939
NET INCOME PER SHARE basic and diluted	\$ 0.13	\$ 0.16	\$ 0.43	\$ 0.48
DIVIDENDS PER SHARE	\$ 0.16	\$ 0.16	\$ 0.48	\$ 0.48
	See accompanying notes			

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

	(In Thousands of Dollars)	
	Nine Months Ended	
	Sept. 30,	Sept. 30,
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
NET CASH FROM OPERATING ACTIVITIES	\$ 7,265	\$ 8,469
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and repayments of securities available for sale	28,982	44,705
Proceeds from sales of securities available for sale	24,810	19,758
Proceeds from sale of other real estate owned	24	92
Purchases of securities available for sale	(36,186)	(59,328)
Purchases of restricted securities	(177)	(139)
Loan originations and payments, net	(667)	(27,831)
Additions to premises and equipment	(389)	(357)
NET CASH FROM INVESTING ACTIVITIES	16,397	(23,100)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in deposits	(26,309)	4,845
Net change in short-term borrowings	8,408	14,178
Proceeds from Federal Home Loan Bank borrowings and other debt	10,000	11,094
Repayment of Federal Home Loan Bank borrowings and other debt	(6,652)	(13,625)
Repurchase of Treasury Stock	(2,459)	(2,213)
Cash dividends paid	(6,170)	(6,255)
Proceeds from dividend reinvestment	2,819	3,348
NET CASH FROM FINANCING ACTIVITIES	(20,363)	11,372
NET CHANGE IN CASH AND CASH EQUIVALENTS	3,299	(3,259)
Beginning cash and cash equivalents	31,614	33,570
Ending cash and cash equivalents	\$ 34,913	\$ 30,311
Supplemental cash flow information:		
Interest paid	(14,327)	(10,761)
Income taxes paid	(1,680)	(2,455)
Supplemental noncash disclosure:		
Transfer of loans to other real estate owned	26	70

See accompanying notes

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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 2005 Annual Report to Shareholders included in the Company s 2005 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.

Stock Options:

Prior to January 1, 2006, the Company accounted for stock-based compensation expense using the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and as permitted by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation. No compensation cost for stock options was reflected in net income for 2005, as all options granted had an exercise price equal to the market price of the underlying common stock at date of grant.

On January 1, 2006, the Company adopted SFAS No. 123(R) (revised version of SFAS No. 123) which requires measurement of compensation cost for all stock-based awards be based on the grant-date fair value and recognition of compensation cost over the requisite service period of stock-based awards, which is usually the same as the period over which the options vest. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the

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Company's valuation methodology previously utilized for options in footnote disclosures required under SFAS No. 123. The fair value of future stock grants will also be determined using the Black-Scholes valuation model. The Company has adopted SFAS No. 123(R) using the modified prospective method, which provides for no retroactive application to prior periods and no cumulative adjustment to equity accounts. It also provides for expense recognition, for both new and existing stock-based awards, as the required services are rendered. SFAS No. 123(R) also amends SFAS No. 95, Statement of Cash Flows, and requires tax benefits relating to excess stock-based compensation deductions be presented in the statement of cash flows as financing cash inflows.

On March 29, 2005, the Securities and Exchange Commission (SEC) published Staff Accounting Bulletin No. 107 (SAB 107), which expressed the views of the Staff regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations and provided the Staff's views regarding the valuation of stock-based payment arrangements for public companies. SAB 107 requires that stock-based compensation be classified in the same expense category as cash compensation. Accordingly, the Company has included stock-based compensation expense in salaries and employee benefits in the condensed consolidated statements of income.

The adoption of SFAS No. 123(R) had the following effect on reported amounts compared with amounts that would have been reported using the intrinsic value method under previous accounting.

	Three months ended Sept. 30, 2006			Nine months ended Sept. 30, 2006		
	Using Previous Accounting	SFAS 123(R) Adjustment	As Reported	Using Previous Accounting	SFAS 123(R) Adjustment	As Reported
Income before taxes	\$ 2,211	\$ (6)	\$ 2,205	\$ 7,220	\$ (20)	\$ 7,200
Income taxes	454	0	454	1,599	0	1,599
Net Income	\$ 1,757	\$ (6)	\$ 1,751	\$ 5,621	\$ (20)	\$ 5,601
Basic earnings per share	\$.13	\$ 0	\$.13	\$.43	\$ 0	\$.43
Diluted earnings per share	.13	0	.13	.43	0	.43

The following table illustrates the effect on the prior year comparable periods net income and earnings per share if expense had been measured using the fair value recognition provision of SFAS No. 123(R).

	Three months ended Sept. 30, 2005			Nine months ended Sept. 30, 2005		
	As Reported	SFAS 123(R) Adjustment	If Under SFAS 123(R)	As Reported	SFAS 123(R) Adjustment	If Under SFAS 123(R)
Income before taxes	\$ 2,695	\$ (7)	\$ 2,688	\$ 8,323	\$ (21)	\$ 8,302
Income taxes	667	0	667	2,126	0	2,126
Net Income	\$ 2,028	\$ (7)	\$ 2,021	\$ 6,197	\$ (21)	\$ 6,176
Basic earnings per share	\$.16		\$.16	\$.48		\$.48
Diluted earnings per share	.16		.16	.48		.48

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Options to buy stock are granted to directors, officers and employees under the Company's Stock Option Plan, which provides for issue of up to 375,000 options. Exercise price is the market price at the date of grant. The maximum option term is ten years, and options vest over a five year period. All options outstanding were granted in 2001 and will become fully vested in 2006. Shares with respect to which options may be granted may be either authorized and unissued shares or shares issued and thereafter acquired by the Company.

A summary of the activity in the plan is as follows:

	Three months ended September 30, 2006			Nine months ended September 30, 2006		
	Total options outstanding			Total options outstanding		
	Shares	Weighted Average Exercise Price	Weighted Average Fair Value	Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding, beginning of period	48,000	\$ 11	\$ 2.71	49,500	\$ 11	\$ 2.71
Forfeited	0			1,500		
Exercised	0			0		
Granted	0			0		
Outstanding, end of period	48,000	\$ 11	\$ 2.71	48,000	\$ 11	\$ 2.71
Exercisable, end of period	38,400	\$ 11	\$ 2.71	38,400	\$ 11	\$ 2.71

The fair value of the Farmers National Banc Corp. stock at September 30, 2006 was below the exercisable option price, therefore the outstanding and exercisable options had no intrinsic value.

The remaining compensation cost yet to be recognized for stock-based awards that have been awarded but not vested is \$3 thousand. This cost will be recognized in its entirety in 2006.

Securities:

Securities available for sale at September 30, 2006 and December 31, 2005 are summarized as follows:

(In Thousands of Dollars)	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
September 30, 2006			
U.S. Treasury and U.S. Government sponsored enterprises	\$ 73,919	\$ 95	\$ (963)
Corporate debt securities	1,255	0	(2)
Mortgage-backed securities	98,738	62	(3,332)
Obligations of states and political subdivisions	62,069	772	(147)
	Total debt securities	929	(4,444)
	Equity securities	1,082	0
	TOTALS	\$ 2,011	\$ (4,444)

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(In Thousands of Dollars) December 31, 2005	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
U.S. Treasury and U.S. Government sponsored enterprises	\$ 78,299	\$ 20	\$ (1,144)
Corporate debt securities	2,270	14	0
Mortgage-backed securities	110,725	13	(3,660)
Obligations of states and political subdivisions	59,710	555	(647)
Total debt securities	251,004	602	(5,451)
Equity securities	8,481	947	0
TOTALS	\$ 259,485	\$ 1,549	\$ (5,451)

Unrealized losses on debt securities issued by the U.S. Treasury 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 timely repayment of principal and interest on these securities is guaranteed by the issuer, these securities are backed by performing assets, 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.

Earnings Per Share:

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

(Dollars in Thousands, except Per Share Data)	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Basic EPS computation				
Numerator Net income	\$ 1,751	\$ 2,028	\$ 5,601	\$ 6,197
Denominator Weighted average shares outstanding	13,033,836	13,026,556	12,998,179	12,999,174
Basic earnings per share	\$.13	\$.16	\$.43	\$.48
Diluted EPS computation				
Numerator Net income	\$ 1,751	\$ 2,028	\$ 5,601	\$ 6,197
Denominator Weighted average shares outstanding for basic earnings per share	13,033,836	13,026,556	12,998,179	12,999,174
Effect of Stock Options	0	10,690	1,480	12,154
			&nbs	