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

þ **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 þ No o

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 o Accelerated filer þ Non-accelerated filer o

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

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 October 31, 2006
Common Stock, No Par Value	13,036,262 shares

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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

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, 2006	**Sept. 30, 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 Total options outstanding			Nine months ended September 30, 2006 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) **September 30, 2006**	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
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	235,981	929	(4,444)
Equity securities	7,183	1,082	0
TOTALS	$ 243,164	$ 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, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 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
Weighted averages shares for diluted earnings per share	13,033,836	13,037,246	12,999,659	13,011,328
Diluted earnings per share	$ .13	$ .16	$ .43	$ .48

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Comprehensive Income:

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income consists solely of unrealized gains and losses on securities available for sale.

Reclassifications:

Certain items in the prior year financial statements were reclassified to conform to the current presentation.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans,* an amendment of FASB Statements No. 07, 08, 106 and 132(R). SFAS No. 158 requires employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. SFAS No. 158 requires an employer to (a) recognize in its statement of financial position an asset for a plan s overfunded status or a liability for a plan s underfunded status, (b) measure a plan s assets and its obligations that determine its funded status at the end of the employer s fiscal year (c) recognize changes in the funded status of a defined postretirement plan in the year in which the changes occur. Those changes will be reported in the comprehensive income of a business entity. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006, for publicly traded companies. The requirement to measure plan assets and benefit obligations as of the date of the employer s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Management does not expect that the adoption of this standard will have a material effect on Farmers financial statements since the Company does not have a defined benefit plan.

In September 2006, FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Management does not expect that the adoption of this standard will have a material impact on the Company s financial statements.

In July 2006, the Emerging Issues Task Force (EITF) of FASB issued a draft abstract for EITF Issue No. 06-04, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangement.* This draft abstract from EITF reached a consensus that for an endorsement split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with SFAS No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions.* The Task Force concluded that a liability for the benefit obligation under SFAS No. 106 has not been settled through the purchase of an endorsement type life insurance policy. In September 2006, FASB agreed to ratify the consensus reached in EITF Issue No. 06-04. This new accounting standard will be effective for fiscal years beginning after December 15, 2007. At September 30, 2006, Farmers owned no life insurance policies subject to endorsement split-dollar life insurance arrangements. Thus, management does not believe that the adoption of EITF Issue No. 06-4 will have a material impact on the Company s financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 108. This SAB expresses the SEC s views regarding the process of quantifying financial statement misstatements. SAB No. 108 provides guidance on the consideration of the effects of prior year misstatements for the purpose of a materiality assessment. SAB No. 108 is effective for fiscal years ending after November 15, 2006. Management has not yet determined the impact of adoption of this Bulletin.

In March 2006, the FASB issued FAS No. 156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140,* which changes the accounting for all loan servicing rights which are recorded as the result of selling a loan where the seller undertakes an obligation to service the loan, usually in exchange for compensation. FAS 156 amends current accounting guidance by permitting the servicing right to be recorded initially at fair value and also permits the subsequent reporting of these assets at fair value. FAS 156 is effective beginning January 1, 2007. Because the Company has no obligation to service loans for others, management does not expect the adoption of this standard to have a material impact on the Company s financial statements.

In July 2006, the FASB issued Financial Accounting Standards Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes.* FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprises financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Management does not expect that the adoption of this standard will have a material impact on the Company s financial statements.

In February 2006, the FASB issued SFAS 155, *Accounting for Certain Hybrid Financial Instruments,* an amendment of SFAS No. 133 and 140. This Statement changes the accounting for various derivatives and securitized financial assets. This Statement will be effective for all financial instruments acquired, issued, or subject to a remeasurement (new basis) event occurring after the beginning in 2007. Management does not expect the adoption of this standard to have a material impact on the Company 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.

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Results of Operations

Comparison of selected financial ratios and other results for the three-month and nine-month periods ending September 30, 2006 and 2005:

	Three months ended September 30,		Nine months ended September 30,	
(Dollars in Thousands, except Per Share Data)	**2006**	**2005**	**2006**	**2005**
Total Assets	$816,691	$832,985	$816,691	$832,985
Net Income	$ 1,751	$ 2,028	$ 5,601	$ 6,197
Basic and Diluted Earnings per share	$ .13	$ .16	$ .43	$ .48
Return on Average Assets (annualized)	.85%	.96%	.91%	1.00%
Return on Average Equity (annualized)	9.36%	10.37%	10.00%	10.63%
Efficiency Ratio	70.36%	64.00%	68.06%	63.83%
Capital to Asset Ratio	9.38%	9.30%	9.38%	9.30%
Dividends to Net Income	119.07%	102.51%	111.23%	100.56%
Loans to Assets	62.64%	61.45%	62.64%	61.45%
Net Loans to Deposits	83.67%	80.65%	83.67%	80.65%

Net Interest Income. The following schedules detail 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.

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Average Balance Sheets and Related Yields and Rates
(Dollar Amounts in Thousands)

	Three Months Ended September 30, 2006			Three Months Ended September 30, 2005		
	AVERAGE BALANCE	INTEREST	RATE (1)	AVERAGE BALANCE	INTEREST	RATE (1)
EARNING ASSETS						
Loans	**$ 509,388**	**$ 8,537**	**6.65%**	$ 503,240	$ 8,159	6.43%
Taxable securities	**185,822**	**1,862**	**3.98**	211,141	2,004	3.77
Tax-exempt securities	**64,343**	**972**	**5.99**	55,698	861	6.13
Equity Securities (2)	**11,119**	**202**	**7.21**	12,328	114	3.67
Federal funds sold	**5,502**	**71**	**5.12**	8,874	77	3.44
Total earning assets	**776,176**	**11,644**	**5.95**	791,282	11,215	5.62
NONEARNING ASSETS						
Cash and due from banks	**23,438**			27,175		
Premises and equipment	**14,926**			15,356		
Allowance for Loan Losses	**(5,877)**			(6,134)		
Other assets	**7,400**			8,591		
Total Assets	**$ 816,063**			$ 836,271		
INTEREST-BEARING LIABILITIES						
Time deposits	**$ 273,158**	**$ 2,887**	**4.19%**	$ 282,672	$ 2,360	3.31%
Savings deposits	**173,578**	**944**	**2.16**	157,465	333	0.84
Demand deposits	**104,973**	**183**	**0.69**	136,510	325	0.94
Repurchase agreements	**82,856**	**728**	**3.49**	81,890	521	2.52
Borrowings	**44,270**	**513**	**4.60**	40,487	446	4.37
Total Interest-Bearing Liabilities	**678,835**	**5,255**	**3.07**	699,025	3,985	2.26
NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS EQUITY						
Demand deposits	**57,588**			56,050		
Other Liabilities	**5,457**			3,582		
Stockholders equity	**74,183**			77,614		
	$ 816,063			$ 836,271		

Total Liabilities and Stockholders Equity				
Net interest income	**$ 6,389**		$ 7,230	
Net interest margin		**3.27%**		3.63%

(1) Rates are calculated on an annualized basis.

(2) Equity securities include restricted stock, which is included in other assets on the consolidated balance sheets.

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Average Balance Sheets and Related Yields and Rates
(Dollar Amounts in Thousands)

	Nine Months Ended September 30, 2006			Nine Months Ended September 30, 2005		
	AVERAGE BALANCE	INTEREST	RATE (1)	AVERAGE BALANCE	INTEREST	RATE (1)
EARNING ASSETS						
Loans	**$ 509,118**	**$ 24,941**	**6.55%**	$ 492,081	$ 23,545	6.40%
Taxable securities	**189,254**	**5,620**	**3.97**	217,668	6,263	3.85
Tax-exempt securities	**61,708**	**2,817**	**6.10**	50,544	2,376	6.29
Equity Securities (2)	**11,512**	**525**	**6.10**	12,855	356	3.70
Federal funds sold	**7,590**	**278**	**4.90**	8,875	196	2.95
Total earning assets	**779,182**	**34,181**	**5.87**	782,023	32,736	5.60
NONEARNING ASSETS						
Cash and due from banks	**24,618**			27,197		
Premises and equipment	**14,968**			15,453		
Allowance for Loan Losses	**(5,884)**			(6,159)		
Other assets	**7,764**			8,974		
Total Assets	**$ 820,648**			$ 827,488		
INTEREST-BEARING LIABILITIES						
Time deposits	**$ 279,006**	**$ 8,334**	**3.99%**	$ 265,374	$ 6,441	3.25%
Savings deposits	**165,136**	**2,217**	**1.79**	177,163	1,187	0.90
Demand deposits	**115,029**	**681**	**0.79**	132,331	869	0.88
Repurchase agreements	**77,392**	**1,896**	**3.28**	76,298	1,214	2.13
Borrowings	**46,732**	**1,596**	**4.57**	39,186	1,284	4.38
Total Interest-Bearing Liabilities	**683,295**	**14,724**	**2.88**	690,352	10,995	2.13
NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS EQUITY						
Demand deposits	**57,390**			55,527		
Other Liabilities	**5,079**			3,665		
Stockholders equity	**74,884**			77,944		
	$ 820,648			$ 827,488		

Total Liabilities and Stockholders Equity				
Net interest income	**$ 19,457**		$ 21,741	
Net interest margin		**3.34%**		3.72%

(1) Rates are calculated on an annualized basis.

(2) Equity securities include restricted stock, which is included in other assets on the consolidated balance sheets.

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Taxable equivalent net interest income. Taxable equivalent net interest income for the first nine months of September 30, 2006 totaled $19.457 million, a decrease of $2.284 million or 10.51% compared to the first nine months of 2005. This decline is primarily due to an increase in interest expense of $3.73 million or 33.92%. Interest expense increased as deposits shifted out of the lower costing savings deposits and into the higher costing time deposits. Interest expense on time deposits increased $1.893 million as average balances grew $13.632 million or 5.14%. Interest income increased $1.445 million or 4.41% during the same period. The Corporation s tax equated annualized net interest margin decreased from 3.72% for the period ending September 30, 2005 to 3.34% for the period ending September 30, 2006. This decline was primarily due to the shift in deposit mix to higher costing time deposits. Management will continue to evaluate future interest rate changes so that assets and liabilities may be priced accordingly to minimize the impact on the net interest margin.

Taxable equivalent net interest income for the quarter ended September 30, 2006 totaled $6.389 million, a decrease of $841 thousand or 11.63% compared to the quarter ended September 30, 2005. The increase in interest expense is attributable to the 81 basis point increase in the cost of interest-bearing liabilities. Average savings deposits increased by $16.11 million or 10.23% over the prior year comparable quarter which helped drive up interest expense on savings deposits by $611 thousand. The interest expense related to deposits and repurchase agreements increased 33.99% over the prior year comparable quarter which is consistent with the market increase in short-term interest rates.

Noninterest Income. Total noninterest income for the nine month period ended September 30, 2006 increased by $637 thousand or 19.17% compared to the same period in 2005. This increase is mainly due to a $227 thousand increase in gains on the sale of investment securities. Fees from overdrafts and return check charges also increased $204 thousand or 10.00%.

Total noninterest income for the quarter ended September 30, 2006 increased by $148 thousand from the prior year comparable quarter. Other operating income from various sources increased $85 thousand or 25.99%.

Noninterest Expense. Noninterest expense was $14.67 million for the first nine months of 2006 compared to $15.11 million for the same period in 2005. This amounts to a decrease of 2.93%. Most of this decrease is the result of a $154 thousand decline in occupancy and equipment expense and a $181 thousand decrease in other operating expenses.

Noninterest expense was $5.02 million for the quarter ended September 30, 2006 compared to $5.07 million for the same quarter in 2005. This slight decrease again occurred mainly in occupancy and equipment expense and other operating expenses.

The efficiency ratio increased to 68.06% for the first nine months of 2006 compared to 63.83% for the first nine months of 2005. The efficiency ratio was adversely impacted by the $2.53 million decline in net interest income, despite a $442 thousand decrease in noninterest expenses. The efficiency ratio is calculated as follows: non-interest expense divided by the sum of net interest income plus non-interest income, excluding security gains. This ratio is a measure of the expense incurred to generate a dollar of revenue. Management will continue to closely monitor the efficiency ratio.

Income Taxes. Income tax expense totaled $1.599 million for the first nine months of 2006 and $2.126 million for the first nine months of 2005, a decrease of $527 thousand or 24.79%. The effective tax rate for the first nine months of 2006 was 22.20% compared to 25.54% for the same time in 2005. Income tax expense totaled $454 thousand for the quarter ended September 30, 2006 and $667 thousand for the quarter ended September 30, 2005, a decrease of 31.93%. This decrease is a result of the Corporation s increased purchases of tax-exempt municipal securities combined with a decrease in pretax income.

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Other Comprehensive Income. For the first nine months of 2006, the change in net unrealized gains on securities, net of reclassifications, resulted in a gain of $955 thousand compared to a loss of $2.26 million for the same period in 2005. The third quarter also had a gain of $3.12 million compared to a loss of $1.34 million for the same quarter in 2005. The change was due to debt and equity market recoveries after several interest rate increases.

Financial Condition

Total assets decreased $10.378 million or 1.25% since December 31, 2005, as the Corporation saw a decline in deposit balances. Capital ratios remain solid, as shown by the ratio of equity to total assets at September 30, 2006 of 9.38%.

Securities. Securities available for sale decreased $16.32 million. Matured securities were used to partially fund the decrease of $26.309 million in deposits. The Corporation sold $24.8 million in market value of debt and equity securities, resulting in a gain of $517 thousand. In addition, there was a $955 thousand increase in the net unrealized gains (losses) on securities.

Loans. Gross loans decreased slightly since December 31, 2005. Commercial Real Estate loans grew $16.736 million or 10.16% since December 31, 2005. The growth in commercial real estate loans offset the decline in balance in indirect installment loans, which decreased $18.677 million or 14.78%. Commercial Real Estate loans have grown as the Corporation has used a combination of experienced personnel and marketing strategies to build this section of the portfolio as the local economy continues to recover. Loans contributed 75.10% of total interest income for the nine months ended September 30, 2006 and 73.72% for the nine months ended September 30, 2005.

Allowance for Loan Losses. The following table indicates key asset quality ratios that management evaluates on an ongoing basis.

Asset Quality History

(In Thousands of Dollars)

	9/30/06	6/30/06	3/31/06	12/31/05	9/30/05
Nonperforming loans	$ 1,853	$ 1,884	$ 2,609	$ 2,017	$ 1,593
Nonperforming loans as a % of total loans	.36%	.37%	.51%	.39%	.31%
Allowance for loan losses	$ 5,845	$ 5,848	$ 5,870	$ 5,860	$ 6,144
Allowance for loan losses as a % of loans	1.14%	1.15%	1.15%	1.14%	1.20%
Allowance for loan losses as a % of nonperforming loans	315.39%	310.33%	224.99%	290.53%	385.69%

The allowance for loan losses as a percentage of loans at September 30, 2006 equaled the December 31, 2005 amount of 1.14%. The provision for loan losses for the first nine months of 2006 and 2005 was $200 thousand and $529 thousand, respectively. Net charge-offs totaled $215 thousand for the first nine months of 2006 down from $529 thousand for the first nine months of 2005. The provision for loan losses was $30 thousand for the quarter ended September 30, 2006 compared to $260 thousand for the same time in 2005. The provision closely tracks net charge-offs. Approximately 80% of gross charge-offs have occurred in the indirect loan portfolio during the first nine months of 2006 and 2005. Non-performing loans to total loans have decreased slightly from

.39% as of December 31, 2005 to .36% as of September 30, 2006. The ratio of the allowance for loan losses (ALLL) to non-performing loans remains solid at 315%.

The provision for loan losses is based on management s judgment after taking into consideration all factors connected with the collectibility of the existing loan portfolio. Management evaluates the loan portfolio in light of economic conditions, changes in the nature and volume of the loan portfolio, industry standards and other relevant factors. Specific factors considered by management in determining the amounts charged to operating expenses include previous credit loss experience, the status of past due interest and principal payments, the quality of financial information supplied by loan customers and the general condition of the industries in the community to which loans have been made.

Deposits. Total deposits decreased $26.309 million since December 31, 2005. Balances in the Corporation s money market index accounts increased $34.618 million since December 31, 2005, as management made a concerted effort to aggressively price this variable rate account. The growth in money market index accounts was offset by a decrease of $16.054 million in time deposits. The Company prices deposit rates to remain competitive within the market and to attract and retain customers.

Borrowings. Total borrowings increased $11.756 million or 10.09% since December 31, 2005. The Corporation offset the overall drop in deposits with Securities sold under repurchase agreements, which increased $12.077 million during the nine-month period.

Capital Resources. Total stockholders equity increased from $75.864 million at December 31, 2005 to $76.573 million at September 30, 2006. During the first nine months of 2006, the mark to market adjustment of securities increased accumulated other comprehensive income by $955 thousand and the repurchase of treasury stock decreased stockholders equity by $2.459 million.

The capital management function is a regular process which consists of providing capital for both the current financial position and the anticipated future growth of the Corporation. As of September 30, 2006 the Corporation s total risk-based capital ratio stood at 15.81%, and the Tier I risk-based capital ratio and Tier I leverage ratio were at 14.62% and 9.51%, respectively. Regulations established by the Federal Deposit Insurance Corporation Improvement Act require that for a bank to be considered well capitalized, it must have a total risk-based capital ratio of 10%, a Tier I risk-based capital ratio of 6% and a Tier I leverage ratio of 5%.

Critical Accounting Policies

The Company follows financial accounting and reporting policies that are in accordance with U.S. GAAP. These policies are presented in Note A to the consolidated audited financial statements in Farmers National Banc Corp. s 2005 Annual Report to Shareholders included in Farmers National Banc Corp. s Annual Report on Form 10-K. Critical accounting policies are those policies that require management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company has identified two accounting policies that are critical accounting policies and an understanding of these policies is necessary to understand our financial statements. These policies relate to determining the adequacy of the allowance for loan losses and other-than-temporary impairment of securities. Additional information regarding these policies is included in the notes to the aforementioned 2005 consolidated financial statements, Note A (Summary of Significant Accounting Policies), Note B (Securities), Note C (Loans), and the sections captioned Loan Portfolio and Investment Securities .

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Liquidity

The Corporation maintains, in the opinion of management, liquidity sufficient to satisfy depositors requirements and meet the credit needs of customers. The Corporation depends on its ability to maintain its market share of deposits as well as acquiring new funds. The Corporation s ability to attract deposits and borrow funds depends in large measure on its profitability, capitalization and overall financial condition. The Company s objective in liquidity management is to maintain the ability to meet loan commitments, purchase securities or to repay deposits and other liabilities in accordance with their terms without an adverse impact on current or future earnings. Principal sources of liquidity for the Company include assets considered relatively liquid, such as federal funds sold, cash and due from banks, as well as cash flows from maturities and repayments of loans, and securities.

The primary investing activities of the Company are originating loans and purchasing securities. During the first nine months of 2006, net cash from investing activities amounted to $16.40 million compared to $23.10 million used in investing activities for the same period in 2005. Purchase of securities available for sale amounted to $36.186 million in 2006 compared to $59.328 million in 2005.

Net changes in loans increased by $667 thousand during this year s first nine-month period and increased $27.83 million over the same nine-month period in 2005. The smaller increase in net loan changes during 2006 compared to 2005 can be attributed to the local economic conditions and the rising interest rate environment.

The primary financing activities of the Company are obtaining deposits, repurchase agreements and other borrowings. Net cash used by financing activities amounted to $20.36 million for the first nine months of 2006 compared to $11.37 million provided by financing activities for the same period in 2005. Most of this change is a result of the net decrease in deposits. Deposits decreased $26.31 million for the nine-month period ended September 30, 2006 compared to a $4.85 million decrease for the same period in 2005.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company s ability to maximize net income is dependent, in part, on management s ability to plan and control net interest income through management of the pricing and mix of assets and liabilities. Because a large portion of assets and liabilities of the Company are monetary in nature, changes in interest rates and monetary or fiscal policy affect its financial condition and can have significant impact on the net income of the Company.

The Company monitors its exposure to interest rate risk on a quarterly basis through simulation analysis which measures the impact changes in interest rates can have on net income. The simulation technique analyzes the effect of a presumed 100 and 200 basis points shift in interest rates and takes into account prepayment speeds on amortizing financial instruments, loan and deposit volumes and rates, non-maturity deposit assumptions and capital requirements. The results of the simulation indicate that in an environment where interest rates rise or fall 100 and 200 basis points over a 12 month period, using September 30, 2006 amounts as a base case, the Company s change in net interest income would be within the board mandated limits.

The information required by Item 3 has been disclosed in Item 7A of the Company s Annual Report to Shareholders on Form 10-K for the year ended December 31, 2005. There has been no material change in the disclosure regarding market risk due to the stability of the balance sheet.

Item 4. Controls and Procedures

Based on their evaluation, as of the end of the period covered by this quarterly report, the Company s Chief Executive Officer and Chief Financial Officer have concluded the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange

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Act of 1934) are effective. There have been no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. The Company s Chief Executive Officer and Chief Financial Officer have also concluded there have been no changes over the Company s internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

There are no material pending legal proceedings to which the registrant or its subsidiary is a party, or of which any of their property is the subject, except proceedings which arise in the ordinary course of business. In the opinion of management, pending legal proceedings will not have a material effect on the consolidated financial position of the registrant and its subsidiary.

Item 1A. Risk Factors

For information regarding factors that could affect the Corporation s results of operations, financial condition and liquidity, see the risk factors discussion provided under Part 1, Item 1A on Form 10-K for the fiscal year ended December 31, 2005. See also, Forward-Looking Statements included in Part 1, Item 2 of this Quarterly Report on Form 10-Q. There have been no material changes in risk factors since December 31, 2005.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds Purchases of equity securities by the issuer.

Purchases of equity securities by the issuer.

On June 13, 2006, the Corporation announced the adoption of a stock repurchase program that authorizes the repurchase of up to 4.9% or approximately 635,117 shares of its outstanding common stock in the open market or in privately negotiated transactions. This program expires in June 2007.

The following table summarizes the treasury stock purchased by the issuer during the third quarter of 2006:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet Be Purchased Under the Program
July 1 31	13,019	$ 10.91	13,019	622,098
August 1 31	0		0	622,098
Sept.1 30	33,500	$ 10.75	33,500	588,598
TOTAL	46,519	$ 10.79	46,519	588,598

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

(a) The following exhibits are filed or incorporated by reference as part of this report:

2. Not applicable.

3(i). The Articles of Incorporation, including amendments thereto for the Registrant. Incorporated by reference to Exhibit 4.1 to Farmers National Banc Corp s Form S-3 Registration Statement dated October 3, 2001. (File No. 0-12055).

3(ii). The Code of Regulations, including amendments thereto for the Registrant. Incorporated by reference to Exhibit 4.2 to Farmers National Banc Corp s Form S-3 Registration Statement dated October 3, 2001. (File No. 0-12055).

4. Incorporated by reference to initial filing.

10. Not applicable.

11. Refer to notes to unaudited consolidated financial statements.

15. Not applicable.

18. Not applicable.

19. Not applicable.

22. Not applicable.

23. Not applicable.

24. Not applicable.

31.a Certification of Chief Executive Officer (Filed herewith)

31.b Certification of Chief Financial Officer (Filed herewith)

32.a 906 Certification of Chief Executive Officer (Filed herewith)

32.b 906 Certification of Chief Financial Officer (Filed herewith)

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FARMERS NATIONAL BANC CORP.

Dated: November 8, 2006
/s/ Frank L. Paden
Frank L. Paden
President and Secretary

Dated: November 8, 2006
/s/ Carl D. Culp
Carl D. Culp
Executive Vice President
and Treasurer