FARMERS NATIONAL BANC CORP /OH/
Form 10-Q
August 08, 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 June 30, 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 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 July 31, 2007
Common Stock, No Par Value	13,009,147 shares

PART I FINANCIAL INFORMATION

Table of Contents

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

	(In Thousands of Dollars)	
	June 30, 2007	**December 31, 2006**
ASSETS		
Cash and due from banks	$ 20,454	$ 24,447
Federal funds sold	1,030	9,591
TOTAL CASH AND CASH EQUIVALENTS	21,484	34,038
Securities available for sale	237,959	255,799
Loans	512,226	508,188
Less allowance for loan losses	5,593	5,594
NET LOANS	506,633	502,594
Premises and equipment, net	14,632	14,744
Other assets	15,148	14,409
TOTAL ASSETS	$795,856	$821,584
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Noninterest-bearing	$ 61,486	$ 66,003
Interest-bearing	526,840	553,744
TOTAL DEPOSITS	588,326	619,747
Short-term borrowings	73,525	77,792
Long-term borrowings	55,766	41,601
Other liabilities	4,497	6,221
TOTAL LIABILITIES	722,114	745,361
Commitments and contingent liabilities		
Stockholders Equity:		
Common Stock Authorized 25,000,000 shares; issued 14,736,615 in 2007 and 14,567,280 in 2006	90,149	88,366

Retained earnings	8,777	9,617
Accumulated other comprehensive income (loss)	(2,714)	(1,345)
Treasury stock, at cost; 1,690,968 shares in 2007 and 1,494,525 in 2006	(22,470)	(20,415)
TOTAL STOCKHOLDERS EQUITY	73,742	76,223
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$795,856	$821,584

See accompanying notes

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		For the Six Months Ended	
	June 30, 2007	**June 30, 2006**	**June 30, 2007**	**June 30, 2006**
INTEREST AND DIVIDEND INCOME				
Loans, including fees	$ 8,665	$ 8,197	$17,030	$16,220
Taxable securities	1,774	1,884	3,626	3,758
Tax exempt securities	682	612	1,364	1,199
Dividends	141	168	285	278
Federal funds sold	70	165	98	207
TOTAL INTEREST AND DIVIDEND INCOME	11,332	11,026	22,403	21,662
INTEREST EXPENSE				
Deposits	4,060	3,791	8,189	7,219
Short-term borrowings	706	668	1,353	1,191
Long-term borrowings	592	528	1,170	1,059
TOTAL INTEREST EXPENSE	5,358	4,987	10,712	9,469
NET INTEREST INCOME	5,974	6,039	11,691	12,193
Provision for loan losses	55	60	115	170
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,919	5,979	11,576	12,023
NONINTEREST INCOME				
Service charges on deposit accounts	721	759	1,401	1,442
Security gains	0	138	552	395
Other operating income	419	434	784	787
TOTAL NONINTEREST INCOME	1,140	1,331	2,737	2,624
NONINTEREST EXPENSES				
Salaries and employee benefits	3,049	2,875	5,987	5,667
Occupancy and equipment	651	595	1,328	1,241
State and local taxes	226	225	453	450
Professional fees	146	113	293	260
Loan expenses	100	104	177	199
Other operating expenses	999	977	2,051	1,835

TOTAL NONINTEREST EXPENSES	5,171	4,889	10,289	9,652
INCOME BEFORE INCOME TAXES	1,888	2,421	4,024	4,995
INCOME TAXES	368	533	695	1,145
NET INCOME	$ 1,520	$ 1,888	$ 3,329	$ 3,850
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Change in net unrealized gains (losses) on securities, net of reclassifications	(1,527)	(2,165)	(1,369)	(2,169)
COMPREHENSIVE INCOME (LOSS)	($ 7)	($ 277)	$ 1,960	$ 1,681
NET INCOME PER SHARE basic and diluted	$ 0.12	$ 0.15	$ 0.26	$ 0.30
DIVIDENDS PER SHARE	$ 0.16	$ 0.16	$ 0.32	$ 0.32

See accompanying notes

2

Table of Contents

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

	(In Thousands except Per Share Data) Six Months Ended	
	June 30, 2007	**June 30, 2006**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 3,329	$ 3,850
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	115	170
Depreciation and amortization	537	514
Net amortization of securities	198	641
Security gains	(552)	(395)
Federal Home Loan Bank dividends	0	(117)
Net change in other assets and liabilities	(1,849)	540
NET CASH FROM OPERATING ACTIVITIES	1,778	5,203
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and repayments of securities available for sale	20,436	24,840
Proceeds from sales of securities available for sale	2,712	8,459
Purchases of securities available for sale	(7,060)	(27,234)
Loan originations and payments, net	(4,154)	556)
Additions to premises and equipment	(302)	(273)
NET CASH FROM INVESTING ACTIVITIES	11,632	6,348
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in deposits	(31,421)	(12,205)
Net change in short-term borrowings	(4,267)	1,094
Proceeds from Federal Home Loan Bank borrowings and other debt	20,000	10,000
Repayment of Federal Home Loan Bank borrowings and other debt	(5,835)	(3,646)
Repurchase of common stock	(2,055)	(1,957)
Cash dividends paid	(4,169)	(4,096)
Proceeds from dividend reinvestment	1,783	1,897
NET CASH FROM FINANCING ACTIVITIES	(25,964)	(8,913)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(12,554)	2,638
Beginning cash and cash equivalents	34,038	31,614
Ending cash and cash equivalents	$ 21,484	$ 34,252

Supplemental cash flow information:

Interest paid	($ 10,865)	($ 8,990)
Income taxes paid	(310)	(1,085)

See accompanying notes

3

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 June 30, 2007 and December 31, 2006 are summarized as follows:

(In Thousands of Dollars) **June 30, 2007**	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
U.S. Treasury and U.S. Government sponsored enterprises	$ 71,747	$ 15	$ (820)
Mortgage-backed securities	92,880	50	(2,836)
Obligations of states and political subdivisions	68,416	33	(1,630)
Total debt securities	233,043	98	(5,286)
Equity securities	4,916	1,013	0
TOTALS	$237,959	$1,111	$(5,286)

(In Thousands of Dollars) **December 31, 2006**	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
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
TOTALS	$255,799	$1,730	$(3,799)

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:

(Dollars in Thousands, except Per Share Data)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Basic EPS computation				
Numerator Net income	$ 1,520	$ 1,888	$ 3,329	$ 3,850
Denominator Weighted average shares outstanding	13,039,436	12,974,678	13,044,026	12,979,980
Basic earnings per share	$ .12	$ .15	$ .26	$ .30
Diluted EPS computation				
Numerator Net income	$ 1,520	$ 1,888	$ 3,329	$ 3,850
Denominator Weighted average shares outstanding for basic earnings per share	13,039,436	12,974,678	13,044,026	12,979,980
Effect of Stock Options	0	219	0	3,967
Weighted averages shares for diluted earnings per share	13,039,436	12,974,897	13,044,026	12,983,947
Diluted earnings per share	$ .12	$ .15	$ .26	$ .30

For the three-month and six-month periods ended June 30, 2007, 48,000 potential common 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 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. The Company is no longer subject to examination by taxing authorities for years before 2002. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months. The Company recognizes interest and/or penalties related to income tax matters in income tax expense. The Company did not have any amounts accrued for interest and penalties at June 30, 2007.
In September 2006, the FASB EITF finalized Issue No. 06-5, *Accounting for Purchases of Life Insurance Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin No. 85-4* (Accounting for Purchases of Life Insurance). EITF Issue No. 06-5 requires that a policyholder consider contractual terms of a life insurance policy in determining the amount that could be realized under the insurance contract. It also requires that if the contract provides for a greater surrender value if all individual policies in a group are surrendered at the same time, that the surrender value be determined based on the assumption that policies will be surrendered on an individual basis. Lastly, EITF Issue No. 06-5 discusses whether the cash surrender value should be

discounted when the policyholder is contractually limited in its ability to surrender a policy. EITF Issue No. 06-5 was effective January 1, 2007 and the adoption of this standard did not have a material impact on the financial statements.

Newly Issued But Not Yet Effective Accounting Standards

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 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 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

Table of Contents

statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Results of Operations

Overview:

Comparison of selected financial ratios and other results for the three-month and six-month periods ended June 30, 2007 and 2006:

	Three months ended June 30,		Six months ended June 30,	
(Dollars in Thousands, except Per Share Data)	2007	2006	2007	2006
Total Assets	$795,856	$820,206	$795,856	$820,206
Net Income	$ 1,520	$ 1,888	$ 3,329	$ 3,850
Basic and Diluted Earnings per share	$ .12	$ .15	$ .26	$ .30
Return on Average Assets (annualized)	.76%	.92%	.83%	.94%
Return on Average Equity (annualized)	8.12%	10.22%	8.91%	10.33%
Efficiency Ratio (tax equivalent basis)	68.40%	63.58%	69.64%	63.10%
Capital to Asset Ratio	9.27%	8.94%	9.27%	8.94%
Dividends to Net Income	137.04%	109.85%	125.23%	107.66%
Loans to Assets	64.36%	62.26%	64.36%	62.26%
Net Loans to Deposits	86.11%	81.60%	86.11%	81.60%

The Corporation s earnings performance in the second quarter remains slightly below projections for 2007. Earlier this year, some strategic decisions were made to monitor growth and net margin issues relative to performance. Given the modest loan demand and the keen competition for time deposits, efforts have been concentrated to better manage the margin rather than grow the balance sheet in the current interest rate environment. Taking into consideration that there was a slight movement in the shape of the yield curve and internal pricing adjustments on our deposit products, the Corporation has seen favorable movement in the net interest margin during the past ninety days. In addition, the Corporation is focused on improving operating processes to be more efficient in order to improve the non-interest income stream and control non-interest expenses.

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.

Table of Contents

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

	Three Months Ended June 30, 2007			Three Months Ended June 30, 2006		
	AVERAGE BALANCE	INTEREST	RATE (1)	AVERAGE BALANCE	INTEREST	RATE (1)
EARNING ASSETS						
Loans (3) (4) (5)	**$ 506,202**	**$ 8,755**	**6.94%**	$ 507,840	$ 8,293	6.55%
Taxable securities	**171,710**	**1,774**	**4.14**	190,622	1,884	3.96
Tax-exempt securities (5)	**69,944**	**1,016**	**5.83**	61,319	942	6.16
Equity Securities (2) (5)	**9,046**	**163**	**7.23**	11,058	201	7.29
Federal funds sold	**5,330**	**70**	**5.27**	13,471	165	4.91
Total earning assets	**762,232**	**11,778**	**6.20**	784,310	11,485	5.87
NONEARNING ASSETS						
Cash and due from banks	**22,035**			24,941		
Premises and equipment	**14,667**			14,914		
Allowance for Loan Losses	**(5,596)**			(5,890)		
Other assets (3)	**9,516**			7,695		
Total Assets	**$ 802,853**			$ 825,970		
INTEREST-BEARING LIABILITIES						
Time deposits	**$ 266,744**	**$ 3,102**	**4.66%**	$ 277,883	$ 2,807	4.05%
Savings deposits	**168,075**	**815**	**1.94**	167,353	754	1.81
Demand deposits	**98,325**	**143**	**0.58**	115,963	230	0.80
Repurchase agreements	**78,714**	**698**	**3.56**	80,464	661	3.29
Borrowings	**51,036**	**600**	**4.72**	47,138	536	4.56
Total Interest-Bearing Liabilities	**662,894**	**5,358**	**3.24**	688,801	4,988	2.90
NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS EQUITY						
Demand deposits	**59,192**			57,719		
Other Liabilities	**5,649**			5,359		
Stockholders equity	**75,118**			74,091		
Total Liabilities and Stockholders Equity	**$ 802,853**			$ 825,970		

Net interest income and interest rate spread	**$**	**6,420**	**2.96%**	$	6,497	2.97%
Net interest margin			**3.38%**			3.32%

(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.

(3) Non-accrual loans and overdraft deposits are included in other assets.

(4) Interest on loans includes fee income of $463 and $420 for 2007 and 2006 respectively.

(5) For 2007, adjustments of $89 thousand, $335 thousand, and $21 thousand respectively are made to tax equate income on tax exempt loans, tax exempt securities and to reflect a dividends

received deduction on equity securities. For 2006, adjustments of $84 thousand, $288 thousand, and $33 thousand respectively are made to tax equate income on tax exempt loans, tax exempt securities and to reflect a dividends received deduction on equity securities. These adjustments are based on a marginal federal income tax rate of 35%, less disallowances.

Table of Contents

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

	Six Months Ended June 30, 2007			Six Months Ended June 30, 2006		
	AVERAGE BALANCE	INTEREST	RATE (1)	AVERAGE BALANCE	INTEREST	RATE (1)
EARNING ASSETS						
Loans (3) (4) (5)	**$505,321**	**$17,209**	**6.87%**	$508,985	$16,404	6.50%
Taxable securities	**174,854**	**3,626**	**4.18**	190,977	3,758	3.97
Tax-exempt securities (5)	**69,962**	**2,042**	**5.89**	60,367	1,845	6.16
Equity Securities (2) (5)	**9,677**	**327**	**6.81**	11,712	323	5.56
Federal funds sold	**3,737**	**98**	**5.29**	8,658	207	4.82
Total earning assets	**763,551**	**23,302**	**6.15**	780,699	22,537	5.82
NONEARNING ASSETS						
Cash and due from banks	**22,224**			25,206		
Premises and equipment	**14,689**			14,990		
Allowance for Loan Losses	**(5,590)**			(5,887)		
Other assets (3)	**9,615**			7,954		
Total Assets	**$804,489**			$822,962		
INTEREST-BEARING LIABILITIES						
Time deposits	**$269,902**	**$ 6,177**	**4.62%**	$281,977	$ 5,448	3.90%
Savings deposits	**171,643**	**1,730**	**2.03**	160,844	1,273	1.60
Demand deposits	**98,140**	**282**	**0.58**	120,121	498	0.84
Repurchase agreements	**74,443**	**1,323**	**3.58**	74,626	1,168	3.16
Borrowings	**50,570**	**1,200**	**4.79**	47,977	1,083	4.55
Total Interest-Bearing Liabilities	**664,698**	**10,712**	**3.25**	685,545	9,470	2.79
NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS EQUITY						
Demand deposits	**58,929**			57,003		
Other Liabilities	**5,486**			5,247		
Stockholders equity	**75,376**			75,167		
	$804,489			$822,962		

Total Liabilities and Stockholders Equity				
Net interest income and interest rate spread	**$12,590**	**2.90%**	$13,067	3.03%
Net interest margin		**3.33%**		3.38%

(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.

(3) Non-accrual loans and overdraft deposits are included in other assets.

(4) Interest on loans includes fee income of $867 and $843 for 2007 and 2006 respectively.

(5) For 2007, adjustments of $178 thousand, $679 thousand, and $41 thousand respectively are made to tax equate income on tax exempt loans, tax exempt securities and to

reflect a dividends received deduction on equity securities. For 2006, adjustments of $172 thousand, $604 thousand, and $45 thousand respectively are made to tax equate income on tax exempt loans, tax exempt securities and to reflect a dividends received deduction on equity securities. These adjustments are based on a marginal federal income tax rate of 35%, less disallowances.

10

Taxable equivalent net interest income. Taxable equivalent net interest income for the first six-months ended June 30, 2007 totaled $12.59 million, a decrease of $477 thousand or 3.65% compared to the first six-months of 2006. Although the yield on earning assets increased by 33 basis points over the past 12 months, this benefit was offset by a 46 basis point increase in the cost of interest-bearing liabilities. The decline in the net interest margin and net interest income continues to be affected by the shape of the yield curve and aggressive competitive pricing in our market areas, which has caused the yield on average earning assets to lag behind the increasing cost of interest-bearing liabilities. Average savings deposits increased by $10.80 million or 6.71% over the prior year six month period, which along with the increased interest rate paid on deposits, helped drive up interest expense on savings deposits by $457 thousand. The interest expense related to time deposits and repurchase agreements increased 13.38% over the prior year comparable period, which is consistent with the market increase in short-term interest rates.

Taxable equivalent net interest income for the quarter ended June 30, 2007 totaled $6.42 million, a slight decrease of $77 thousand or 1.19% compared to the quarter ended June 30, 2006. The increase in interest expense is attributable to the 34 basis point increase in the cost of interest-bearing liabilities. Average interest-bearing demand deposits decreased by $17.64 million or 15.21% over the prior year comparable quarter which helped lower interest expense on demand deposits by $87 thousand.

Noninterest Income. Total noninterest income for the six-month period ended June 30, 2007 increased by $113 thousand or 4.31% compared to the same period in 2006. This increase is due to a $157 thousand increase in gains on the sale of investment securities.

Total noninterest income for the quarter ended June 30, 2007 decreased by $191 thousand from the prior year comparable quarter. This decrease is mainly due to a $138 thousand decrease in gains on the sale of investment securities.

Noninterest Expense. Noninterest expense was $10.29 million for the first six months of 2007 compared to $9.65 million for the same period in 2006. This amounts to an increase of 6.60%. Most of this increase is the result of a $320 thousand increase in salaries and employee benefits mainly attributable to higher health insurance costs.

Noninterest expense was $5.17 million for the quarter ended June 30, 2007 compared to $4.89 million for the same quarter in 2006. Again, this increase is due to the $174 thousand increase in salaries and employee benefits which can be attributed to higher health insurance costs.

The efficiency ratio increased to 69.64% for the first six months of 2007 compared to 63.10% for the first six months of 2006. The efficiency ratio was adversely impacted by the $502 thousand decline in net interest income. The efficiency ratio is calculated as follows: non-interest expense divided by the sum of fully taxable equivalent 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 $695 thousand for the first six months of 2007 and $1.15 million for the first six months of 2006, a decrease of $450 thousand or 39.30%. The effective tax rate for the first six months of 2007 was 17.27% compared to 22.92% for the same time in 2006. Income tax expense totaled $368 thousand for the quarter ended June 30, 2007 and $533 thousand for the quarter ended June 30, 2006, a decrease of 30.96%. The current periods expense was impacted by the Corporation s increased purchases of tax-exempt municipal securities and a decrease in pretax income resulted in the lower tax rate.

Other Comprehensive Income. For the first six months of 2007, the change in net unrealized gains on securities, net of reclassifications, resulted in an unrealized loss of $1.37 million compared to an unrealized loss of $2.17 million for the same period in 2006. The second quarter also had an unrealized loss of $1.53 million compared to an unrealized loss of $2.17 million for the same quarter in 2006. The fair value of these securities is expected to recover as principal payments are received and they approach their maturity date. 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.

Financial Condition

Total assets decreased $25.73 million or 3.13% since December 31, 2006, as the Corporation also saw a decline in deposit balances. Capital ratios remain solid, as shown by the ratio of equity to total assets at June 30, 2007 of 9.27%.

Securities. Securities available for sale decreased $17.84 million. Matured securities were used to partially fund the decrease of $31.42 million in deposits. The Corporation sold $2.7 million in market value of FNMA preferred stock, resulting in a gain of $552 thousand. In addition, there was a $2.11 million decrease in the net unrealized gains (losses) on securities.

Loans. Gross loans increased $4.04 million since December 31, 2006. Commercial Real Estate loans grew $10.57 million or 5.84% since December 31, 2006. The growth in commercial real estate loans offset the decline in balance in indirect installment loans, which decreased $6.59 million or 6.48%. 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. On a fully tax equivalent basis, loans contributed 73.85% of total interest income for the six months ended June 30, 2007 and 72.79% for the six months ended June 30, 2006.

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)

	6/30/07	3/31/07	12/31/06	9/30/06	6/30/06
Nonperforming loans	$ 2,567	$ 2,458	$ 1,722	$ 1,853	$ 1,884
Nonperforming loans as a % of total loans	.50%	.48%	.34%	.36%	.37%
Allowance for loan losses	$ 5,593	$ 5,556	$ 5,594	$ 5,845	$ 5,848
Allowance for loan losses as a % of loans	1.09%	1.10%	1.10%	1.14%	1.15%
Allowance for loan losses as a % of nonperforming loans	217.88%	226.04%	324.85%	315.39%	310.33%

The allowance for loan losses as a percentage of loans at June 30, 2007 was slightly down from the December 31, 2006 amount of 1.10%. The provision for loan losses for the first six months of 2007 and 2006 was $115 thousand and $170 thousand, respectively. Net charge-offs totaled $116 thousand for the first six months of 2007 down from $182 thousand for the first six months of 2006. The provision closely tracks net charge-offs. During 2007 approximately 64% of gross charge-offs have occurred in the indirect loan portfolio compared to 84% in 2006. Non-performing loans to total

Table of Contents

loans have increased from .34% as of December 31, 2006 to .50% as of June 30, 2007. The ratio of the allowance for loan losses (ALLL) to non-performing loans was 218%.

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 $31.42 million since December 31, 2006. Balances in the Corporation s time deposits decreased $15.26 million or 5.44% between December 31, 2006 and June 30, 2007. Money market accounts decreased $8.07 million since December 31, 2006. Given the modest loan demand and the keen competition for time deposits, efforts have been concentrated to better manage the margin rather than grow the balance sheet in the current interest rate environment. The Company prices deposit rates to remain competitive within the market and to retain customers.

Borrowings. Total borrowings increased $9.90 million or 8.29% since December 31, 2006. The Corporation partially offset the drop in deposits with an increase in securities sold under repurchase agreements, which grew $5.81 million during the six-month period.

Capital Resources. Total stockholders equity decreased from $76.22 million at December 31, 2006 to $73.74 million at June 30, 2007. During the first six months of 2007, the mark to market adjustment of securities decreased accumulated other comprehensive income by $1.37 million and the repurchase of treasury stock decreased stockholders equity by $2.06 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 June 30, 2007 the Corporation s total risk-based capital ratio stood at 15.26%, and the Tier I risk-based capital ratio and Tier I leverage ratio were at 14.12% and 9.26%, respectively. Management believes, as of June 30, 2007, that the Corporation and Bank meet all capital adequacy requirements to which they are subject.

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 2006 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 2006 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 .

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 six months of 2007, net cash from investing activities amounted to $11.63 million compared to $6.35 million provided by investing activities for the same period in 2006. Purchases of securities available for sale amounted to $7.06 million in 2007 compared to $27.23 million in 2006. Net loans increased by $4.15 million during this year s first six-month period and decreased $556 thousand over the same six-month period in 2006.

The primary financing activities of the Company are obtaining deposits, repurchase agreements and other borrowings. Net cash used by financing activities amounted to $25.96 million for the first six months of 2007 compared to $8.91 million used by financing activities for the same period in 2006. Most of this change is a result of the net decrease in deposits. Deposits decreased $31.42 million for the six-month period ended June 30, 2007 compared to a $12.21 million decrease for the same period in 2006. The variability in deposits is a result of normal customer deposit activity. Proceeds from Federal Home Loan Bank borrowings amounted to $20 million in 2007 compared to $10 million in 2006.

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 June 30, 2007 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, 2006. 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 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

In the ordinary course of business, Farmers National Bank was named a defendant in a lawsuit filed in September 2005, at which time, the Plaintiff alleges that the Bank is indebted to the Plaintiff for allowing the Plaintiff s former agent to make withdrawals from the Plaintiff s account. The Plaintiff is seeking damages in excess of $423,000 to be determined by a jury trial. While there is no way to determine the ultimate success of defense of the lawsuit at this time, the Bank is defending this matter vigorously.

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, 2006. 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, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of equity securities by the issuer.

On June 12, 2007, the Corporation announced the adoption of a stock repurchase program that authorizes the repurchase of up to 4.9% or approximately 638 thousand shares of its outstanding common stock in the open market or in privately negotiated transactions. This program expires in June 2008.

The following table summarizes the treasury stock purchased by the issuer during the second quarter of 2007:

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
April 1-30	7,525	$ 10.62	7,525	397,034
May 1-31	47,104	$ 10.15	47,104	349,930
June 1-30	56,294	$ 10.53	56,294	581,706
TOTAL	110,923	$ 10.38	110,923	581,706

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Table of Contents

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)

Table of Contents

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: August 8, 2007
/s/Frank L. Paden
Frank L. Paden
President and Secretary
Dated: August 8, 2007
/s/Carl D. Culp
Carl D. Culp
Executive Vice President
and Treasurer