

FARMERS NATIONAL BANC CORP /OH/

Form 10-Q

November 09, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q  
Quarterly Report Under Section 13 or 15(d) of the  
Securities Exchange Act of 1934  
For the Quarter ended September 30, 2007  
Commission file number 0-12055  
FARMERS NATIONAL BANC CORP.  
(Exact name of registrant as specified in its charter)**

OHIO

34-1371693

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No)

20 South Broad Street  
Canfield, OH 44406

44406

(Address of principal executive offices)

(Zip Code)

(330) 533-3341

(Registrant's telephone number, including area code)

Not applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class

Outstanding at October 31, 2007

Common Stock, No Par Value

12,955,098 shares

**PART I FINANCIAL INFORMATION**

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Included in Part I of this report:

Farmers National Banc Corp. and Subsidiary

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FARMERS NATIONAL BANC CORP. AND SUBSIDIARY  
(Unaudited)**

	(In Thousands of Dollars)	
	<b>September 30, 2007</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 23,203	\$ 24,447
Federal funds sold	11,479	9,591
TOTAL CASH AND CASH EQUIVALENTS	34,682	34,038
Securities available for sale	232,958	255,799
Loans	514,352	508,188
Less allowance for loan losses	5,591	5,594
NET LOANS	508,761	502,594
Premises and equipment, net	14,561	14,744
Other assets	14,645	14,409
TOTAL ASSETS	\$805,607	\$821,584
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Deposits:		
Noninterest-bearing	\$ 59,903	\$ 66,003
Interest-bearing	526,954	553,744
TOTAL DEPOSITS	586,857	619,747
Short-term borrowings	85,853	77,792
Long-term borrowings	54,502	41,601
Other liabilities	4,359	6,221
TOTAL LIABILITIES	731,571	745,361
Commitments and contingent liabilities		
Stockholders Equity:	90,924	88,366

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Common Stock	Authorized 25,000,000 shares; issued 14,817,601 in 2007 and 14,567,280 in 2006		
Retained earnings		8,339	9,617
Accumulated other comprehensive income (loss)		(1,264)	(1,345)
Treasury stock, at cost; 1,842,503 shares in 2007 and 1,494,525 in 2006		(23,963)	(20,415)
	TOTAL STOCKHOLDERS EQUITY	74,036	76,223
	TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$805,607	\$821,584

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	
	September	September	September	September
	30,	30,	30,	30,
	2007	2006	2007	2006
<b>INTEREST AND DIVIDEND INCOME</b>				
Loans, including fees	\$ 8,907	\$ 8,438	\$ 25,937	\$ 24,658
Taxable securities	1,711	1,862	5,337	5,620
Tax exempt securities	682	632	2,046	1,831
Dividends	145	168	430	446
Federal funds sold	98	71	196	278
<b>TOTAL INTEREST AND DIVIDEND INCOME</b>	<b>11,543</b>	<b>11,171</b>	<b>33,946</b>	<b>32,833</b>
<b>INTEREST EXPENSE</b>				
Deposits	4,145	4,013	12,334	11,232
Short-term borrowings	752	738	2,105	1,929
Long-term borrowings	651	504	1,821	1,563
<b>TOTAL INTEREST EXPENSE</b>	<b>5,548</b>	<b>5,255</b>	<b>16,260</b>	<b>14,724</b>
<b>NET INTEREST INCOME</b>	<b>5,995</b>	<b>5,916</b>	<b>17,686</b>	<b>18,109</b>
Provision for loan losses	70	30	185	200
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>5,925</b>	<b>5,886</b>	<b>17,501</b>	<b>17,909</b>
<b>NONINTEREST INCOME</b>				
Service charges on deposit accounts	736	802	2,137	2,244
Security gains	9	122	561	517
Other operating income	410	412	1,194	1,199
<b>TOTAL NONINTEREST INCOME</b>	<b>1,155</b>	<b>1,336</b>	<b>3,892</b>	<b>3,960</b>
<b>NONINTEREST EXPENSES</b>				
Salaries and employee benefits	2,924	2,992	8,911	8,659
Occupancy and equipment	656	627	1,984	1,868
State and local taxes	226	222	679	672
Professional fees	133	142	426	398
Loan expenses	98	103	275	302

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Other operating expenses	978	931	3,029	2,770
<b>TOTAL NONINTEREST EXPENSES</b>	<b>5,015</b>	<b>5,017</b>	<b>15,304</b>	<b>14,669</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>2,065</b>	<b>2,205</b>	<b>6,089</b>	<b>7,200</b>
<b>INCOME TAXES</b>	<b>432</b>	<b>454</b>	<b>1,127</b>	<b>1,599</b>
<b>NET INCOME</b>	<b>\$ 1,633</b>	<b>\$ 1,751</b>	<b>\$ 4,962</b>	<b>\$ 5,601</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:</b>				
Change in net unrealized gains (losses) on securities, net of reclassifications	1,450	3,124	81	955
<b>COMPREHENSIVE INCOME (LOSS)</b>	<b>\$ 3,083</b>	<b>\$ 4,875</b>	<b>\$ 5,043</b>	<b>\$ 6,556</b>
<b>NET INCOME PER SHARE - basic and diluted</b>				
	<b>\$ 0.13</b>	<b>\$ 0.13</b>	<b>\$ 0.38</b>	<b>\$ 0.43</b>
<b>DIVIDENDS PER SHARE</b>				
	<b>\$ 0.16</b>	<b>\$ 0.16</b>	<b>\$ 0.48</b>	<b>\$ 0.48</b>

See accompanying notes

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

	(In Thousands except Per Share Data)	
	Nine Months Ended	
	<b>September 30, 2007</b>	<b>September 30, 2006</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 4,962	\$ 5,601
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	185	200
Depreciation and amortization	765	783
Net amortization of securities	283	701
Security gains	(561)	(517)
Federal Home Loan Bank dividends	0	(177)
Net change in other assets and liabilities	(2,274)	497
NET CASH FROM OPERATING ACTIVITIES	3,360	7,088
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from maturities and repayments of securities available for sale	32,104	28,982
Proceeds from sales of securities available for sale	2,720	24,810
Proceeds from sale of other real estate owned	0	24
Purchases of securities available for sale	(11,580)	(36,186)
Loan originations and payments, net	(6,352)	(667)
Additions to premises and equipment	(450)	(389)
NET CASH FROM INVESTING ACTIVITIES	16,442	16,574
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net change in deposits	(32,890)	(26,309)
Net change in short-term borrowings	8,061	8,408
Proceeds from Federal Home Loan Bank borrowings and other debt	20,000	10,000
Repayment of Federal Home Loan Bank borrowings and other debt	(7,099)	(6,652)
Repurchase of common stock	(3,548)	(2,459)
Cash dividends paid	(6,240)	(6,170)
Proceeds from dividend reinvestment	2,558	2,819
NET CASH FROM FINANCING ACTIVITIES	(19,158)	(20,363)
NET CHANGE IN CASH AND CASH EQUIVALENTS	644	3,299
Beginning cash and cash equivalents	34,038	31,614
Ending cash and cash equivalents	\$ 34,682	\$ 34,913
Supplemental cash flow information:		
Interest paid	(16,350)	(14,327)
Income taxes paid	(755)	(1,680)



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

(In Thousands of Dollars)	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
<b>September 30, 2007</b>			
U.S. Treasury and U.S. Government sponsored enterprises	\$ 68,466	\$ 236	\$ (294)
Mortgage-backed securities	89,147	44	(1,976)
Obligations of states and political subdivisions	70,733	164	(824)
Total debt securities	228,346	444	(3,094)
Equity securities	4,612	713	(7)
<b>TOTALS</b>	<b>\$ 232,958</b>	<b>\$ 1,157</b>	<b>\$ (3,101)</b>

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

Unrealized losses on debt securities issued by the U.S. Treasury, U.S. Government agencies, or U.S. Government sponsored enterprises and obligations of state and political subdivisions have not been recognized into income because the securities are of high credit quality, management has the intent and ability to hold these securities for the foreseeable future and the decline in fair value is largely due to fluctuations 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 September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
<b>Basic EPS computation</b>				
Numerator Net income	\$ 1,633	\$ 1,751	\$ 4,962	\$ 5,601
Denominator Weighted average shares outstanding	12,982,677	13,033,836	13,023,352	12,998,179
<b>Basic earnings per share</b>	\$ .13	\$ .13	\$ .38	\$ .43
 <b>Diluted EPS computation</b>				
Numerator Net income	\$ 1,633	\$ 1,751	\$ 4,962	\$ 5,601
Denominator Weighted average shares outstanding for basic earnings per share	12,982,677	13,033,836	13,023,352	12,998,179
Effect of Stock Options	0	0	0	1,480
Weighted averages shares for diluted earnings per share	12,982,677	13,033,836	13,023,352	12,999,659
<b>Diluted earnings per share</b>	\$ .13	\$ .13	\$ .38	\$ .43

For the three-month and nine-month periods ended September 30, 2007 and the three-month period ended September 30, 2006, 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.

**Income Taxes**

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 2003. 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 January 1, 2007.

**Recent Accounting Pronouncements**

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

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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

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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.

**Results of Operations****Overview:**

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

(Dollars in Thousands, except Per Share Data)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Total Assets	\$805,607	\$816,691	\$805,607	\$816,691
Net Income	\$ 1,633	\$ 1,751	\$ 4,962	\$ 5,601
Basic and Diluted Earnings per share	\$ .13	\$ .13	\$ .38	\$ .43
Return on Average Assets (annualized)	.81%	.85%	.83%	.91%
Return on Average Equity (annualized)	8.82%	9.36%	8.88%	10.00%
Efficiency Ratio (tax equivalent basis)	66.09%	66.28%	68.44%	64.34%
Capital to Asset Ratio	9.19%	9.38%	9.19%	9.38%
Dividends to Net Income	126.76%	119.07%	125.74%	111.23%
Loans to Assets	63.85%	62.64%	63.85%	62.64%
Net Loans to Deposits	86.69%	83.67%	86.69%	83.67%

Third quarter earnings performance is the result of continued progress to increase net interest income and improve margins. The quarter ending September 30, 2007 marks the second consecutive quarter-over-quarter that the Corporation has been able to accomplish increases in net interest income, the primary source of revenue. In addition, through a combination of monitoring funding costs and re-pricing earning assets, the bank was able to increase net interest margin by two basis points over the year ended December 31, 2006. During this past quarter, volatility in the credit markets and actions of the Federal Reserve Board caused change in the slope of the yield curve, which increased the spread between long-term and short-term market interest rates. Despite this rate adjustment, the interest rate environment and local economic conditions continue to present challenges with ongoing competition for loans and deposits. 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.

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

	Three Months Ended September 30, 2007			Three Months Ended September 30, 2006		
	AVERAGE		RATE	AVERAGE		RATE
	BALANCE	INTEREST	(1)	BALANCE	INTEREST	(1)
<b>EARNING ASSETS</b>						
Loans (3) (4) (5)	\$ 510,901	\$ 8,993	6.98%	\$ 509,389	\$ 8,530	6.64%
Taxable securities	164,657	1,711	4.12	185,823	1,862	3.98
Tax-exempt securities (5)	70,066	1,023	5.79	64,343	950	5.86
Equity Securities (2) (5)	9,048	165	7.24	11,119	202	7.21
Federal funds sold	7,962	98	4.88	5,502	71	5.12
Total earning assets	762,634	11,990	6.24	776,176	11,615	5.94
<b>NONEARNING ASSETS</b>						
Cash and due from banks	20,819			23,438		
Premises and equipment	14,579			14,926		
Allowance for Loan Losses	(5,614)			(5,877)		
Other assets (3)	8,515			7,400		
Total Assets	\$ 800,933			\$ 816,063		
<b>INTEREST-BEARING LIABILITIES</b>						
Time deposits	\$ 267,170	\$ 3,184	4.73%	\$ 273,158	\$ 2,886	4.19%
Savings deposits	164,382	825	1.99	173,578	944	2.16
Demand deposits	96,957	136	0.56	104,973	183	0.69
Repurchase agreements	79,012	739	3.71	82,856	729	3.49
Borrowings	56,136	664	4.69	44,270	513	4.60
Total Interest-Bearing Liabilities	663,657	5,548	3.32	678,835	5,255	3.07
<b>NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS EQUITY</b>						
Demand deposits	58,197			57,588		
Other Liabilities	5,616			5,457		
Stockholders equity	73,463			74,183		
Total Liabilities and Stockholders Equity	\$ 800,933			\$ 816,063		

Net interest income and interest rate spread	\$	<b>6,442</b>	<b>2.92%</b>	\$	6,360	2.87%
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Net interest margin			<b>3.35%</b>			3.25%
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(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 \$439 thousand and \$389 thousand for 2007 and 2006 respectively.

(5) For 2007, adjustments of \$86 thousand, \$341 thousand, and \$20 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 \$92 thousand, \$318 thousand, and \$34 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)

	Nine Months Ended September 30, 2007			Nine Months Ended September 30, 2006		
	AVERAGE		RATE (1)	AVERAGE		RATE (1)
	BALANCE	INTEREST		BALANCE	INTEREST	
<b>EARNING ASSETS</b>						
Loans (3) (4) (5)	\$ 507,198	\$ 26,202	6.91%	\$ 509,118	\$ 24,919	6.54%
Taxable securities	171,428	5,337	4.16	189,254	5,620	3.97
Tax-exempt securities (5)	69,996	3,065	5.85	61,708	2,740	5.94
Equity Securities (2) (5)	9,465	492	6.95	11,512	525	6.10
Federal funds sold	5,133	196	5.11	7,590	278	4.90
Total earning assets	763,220	35,292	6.18	779,182	34,082	5.85
<b>NONEARNING ASSETS</b>						
Cash and due from banks	21,752			24,618		
Premises and equipment	14,652			14,968		
Allowance for Loan Losses	(5,598)			(5,884)		
Other assets (3)	9,324			7,764		
Total Assets	\$ 803,350			\$ 820,648		
<b>INTEREST-BEARING LIABILITIES</b>						
Time deposits	\$ 268,981	\$ 9,361	4.65%	\$ 279,006	\$ 8,334	3.99%
Savings deposits	169,199	2,555	2.02	165,136	2,217	1.79
Demand deposits	97,739	418	0.57	115,029	681	0.79
Repurchase agreements	75,958	2,062	3.63	77,392	1,896	3.28
Borrowings	52,449	1,864	4.75	46,732	1,596	4.57
Total Interest-Bearing Liabilities	664,326	16,260	3.27	683,295	14,724	2.88
<b>NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS EQUITY</b>						
Demand deposits	58,678			57,390		
Other Liabilities	5,613			5,079		
Stockholders equity	74,733			74,884		
Total Liabilities and Stockholders Equity	\$ 803,350			\$ 820,648		

Net interest income and interest rate spread	\$ 19,032	2.91%	\$ 19,358	2.97%
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Net interest margin		3.33%		3.32%
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(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 \$1,306 thousand and \$1,232 thousand for 2007 and 2006 respectively.

(5) For 2007, adjustments of \$265 thousand, \$1,019 thousand, and \$62 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 \$261 thousand, \$909 thousand, and \$79 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.

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**Taxable equivalent net interest income.** Taxable equivalent net interest income for the first nine-months ended September 30, 2007 totaled \$19.03 million, a decrease of \$326 thousand or 1.68% compared to the first nine-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 39 basis point increase in the cost of interest-bearing liabilities. 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 earning assets to lag behind the increasing cost of interest-bearing liabilities. The effect of these pressures was mitigated somewhat by the greater proportion of interest-earning assets being relatively higher-yielding loans and tax-exempt securities in the current year-to-date period compared to the prior year. Average time deposits decreased by \$10.03 million or 3.59% over the prior year nine-month period but remained proportionately the same as a component of interest-bearing liabilities. The interest rate paid on time deposits was up 66 basis points 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 September 30, 2007 totaled \$6.44 million, a slight increase of \$82 thousand or 1.29% compared to the quarter ended September 30, 2006. The same dynamic that compressed margins in the year-to-date period made it difficult to increase net interest income for the quarter, but a larger proportion of interest-earning assets is comprised of loans and tax-exempt securities, which are higher yielding than other interest-earning assets. The increase in interest expense is partly attributable to the 54 basis point increase in interest costs associated with time deposits. Time deposit balances decreased but remained proportionately the same as a component of interest-bearing liabilities.

**Noninterest Income.** Total noninterest income for the nine-month period ended September 30, 2007 decreased slightly by \$68 thousand or 1.72% compared to the same period in 2006.

Total noninterest income for the quarter ended September 30, 2007 decreased by \$181 thousand from the prior year comparable quarter. This decrease is mainly due to a \$113 thousand decrease in gains on the sale of investment securities.

**Noninterest Expense.** Noninterest expense was \$15.30 million for the first nine months of 2007 compared to \$14.67 million for the same period in 2006. This amounts to an increase of 4.33%. Most of this increase is the result of a \$252 thousand increase in salaries and employee benefits mainly attributable to higher health insurance costs. Noninterest expense was \$5.02 million for both quarters ended September 30, 2007 and September 30, 2006. The efficiency ratio increased to 68.44% for the first nine months of 2007 compared to 64.34% for the first nine months of 2006. The efficiency ratio was adversely impacted by the \$326 thousand decline in taxable equivalent net interest income.

The efficiency ratio improved slightly to 66.09% for the three months ended September 30, 2007 compared with 66.28% for the same three-month period in 2006. The ratio was positively affected by the slight improvement in taxable equivalent 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 \$1.13 million for the first nine months of 2007 and \$1.60 million for the first nine months of 2006, a decrease of \$472 thousand or 29.52%. The effective tax rate for the first nine months of 2007 was 18.51% compared to 22.20% for the same time in 2006. The effective tax rate for the nine-month period ended September 30, 2007 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.

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Income tax expense totaled \$432 thousand for the quarter ended September 30, 2007 and \$454 thousand for the quarter ended September 30, 2006, a decrease of 4.85%.

**Other Comprehensive Income.** For the first nine months of 2007, the change in net unrealized gains on securities, net of reclassifications, resulted in an unrealized gain of \$81 thousand compared to an unrealized gain of \$955 thousand for the same period in 2006. The quarter ended September 30, 2007 also had an unrealized gain of \$1.45 million compared to an unrealized gain of \$3.12 million for the same quarter in 2006. The fair value of these securities should continue 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.

**Financial Condition**

Total assets decreased \$15.98 million or 1.94% since December 31, 2006, as the Corporation also saw a decline in deposit balances. Capital ratios remain strong, as shown by the ratio of equity to total assets at September 30, 2007 of 9.19%.

**Securities.** Securities available for sale decreased \$22.84 million. Matured securities were used to partially fund the decrease of \$32.89 million in deposits. During the first quarter of 2007, the Corporation sold \$2.7 million in market value of FNMA preferred stock, resulting in a gain of \$552 thousand.

**Loans.** Gross loans increased \$6.16 million since December 31, 2006. Commercial Real Estate loans grew \$8.08 million or 4.46% since December 31, 2006. The growth in commercial real estate loans offset the decline in balance in indirect installment loans, which decreased \$6.82 million or 6.70%. 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 74.24% of total interest income for the nine months ended September 30, 2007 and 73.11% for the nine months ended September 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)

	9/30/07	6/30/07	3/31/07	12/31/06	9/30/06
Nonperforming loans	\$ 2,890	\$ 2,567	\$ 2,458	\$ 1,722	\$ 1,853
Nonperforming loans as a % of total loans	.56%	.50%	.48%	.34%	.36%
Allowance for loan losses	\$ 5,591	\$ 5,593	\$ 5,556	\$ 5,594	\$ 5,845
Allowance for loan losses as a % of loans	1.09%	1.09%	1.10%	1.10%	1.14%
Allowance for loan losses as a % of nonperforming loans	193.46%	217.88%	226.04%	324.85%	315.39%

The allowance for loan losses as a percentage of loans at September 30, 2007 was slightly down from the December 31, 2006 amount of 1.10%. The provision for loan losses for the first nine months of 2007 and 2006 was \$185 thousand and \$200 thousand, respectively. Net charge-offs totaled \$189 thousand for the first nine months of 2007 down from \$213 thousand for the first nine months of 2006. The provision closely tracks net charge-offs. During 2007 approximately 69% of gross charge-offs

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have occurred in the indirect loan portfolio compared to 80% in 2006. Non-performing loans to total loans have increased from .34% as of December 31, 2006 to .56% as of September 30, 2007. While the number of non-performing loans remains low, the bulk of the increase can be attributed to a single relationship. The ratio of the allowance for loan losses (ALLL) to non-performing loans was 193%.

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 \$32.89 million since December 31, 2006. Balances in the Corporation's time deposits decreased \$11.80 million or 4.21% between December 31, 2006 and September 30, 2007. Money market accounts decreased \$8.38 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 \$20.96 million or 17.56% since December 31, 2006. The Corporation partially offset the drop in deposits with an increase in securities sold under repurchase agreements, which grew \$18.13 million during the nine-month period.

**Capital Resources.** Total stockholders' equity decreased from \$76.22 million at December 31, 2006 to \$74.04 million at September 30, 2007. During the first nine months of 2007, the mark to market adjustment of securities increased accumulated other comprehensive income by \$81 thousand and the repurchase of treasury stock decreased stockholders' equity by \$3.55 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, 2007 the Corporation's total risk-based capital ratio stood at 15.27%, and the Tier I risk-based capital ratio and Tier I leverage ratio were at 14.16% and 9.36%, respectively. Management believes, as of September 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".

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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 2007, net cash from investing activities amounted to \$16.44 million compared to \$16.57 million provided by investing activities for the same period in 2006. Purchases of securities available for sale amounted to \$11.58 million in 2007 compared to \$36.19 million in 2006. Net loans increased by \$6.35 million during this year's first nine-month period and increased \$667 thousand over the same nine-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 \$19.16 million for the first nine months of 2007 compared to \$20.36 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 \$32.89 million for the nine-month period ended September 30, 2007 compared to a \$26.31 million decrease for the same period in 2006. The variability in deposits is a result of normal customer deposit activity and the Corporation's effort to manage the margin rather than grow the balance sheet. 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 September 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**



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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
July 1-31	36,535	\$ 10.52	36,535	545,171
August 1-31	60,000	\$ 9.80	60,000	485,171
Sept 1-30	55,000	\$ 9.47	55,000	430,171
TOTAL	151,535	\$ 9.85	151,535	430,171

**Item 3. Defaults Upon Senior Securities**

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Not applicable.

**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 9, 2007

/s/Frank L. Paden

Frank L. Paden

President and Secretary

Dated: November 9, 2007

/s/Carl D. Culp

Carl D. Culp

Executive Vice President

and Treasurer