

FARMERS NATIONAL BANC CORP /OH/  
Form 10-Q  
August 10, 2009

**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, 2009**

**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

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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 July 31, 2009
Common Stock, No Par Value	13,415,384 shares



**PART I FINANCIAL INFORMATION**

Item 1 Financial Statements (Unaudited)

Included in Part I of this report:

Farmers National Banc Corp. and Subsidiary

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

	(In Thousands of Dollars)	
	<b>June 30, 2009</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 22,655	\$ 23,803
Federal funds sold	18,632	246
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<b>41,287</b>	<b>24,049</b>
Securities available for sale	281,837	271,605
Loans	593,396	552,005
Less allowance for loan losses	6,640	5,553
<b>NET LOANS</b>	<b>586,756</b>	<b>546,452</b>
Premises and equipment, net	14,105	14,139
Bank owned life insurance	11,278	11,021
Goodwill	3,679	0
Other intangibles	4,092	0
Other assets	14,814	13,104
<b>TOTAL ASSETS</b>	<b>\$ 957,848</b>	<b>\$ 880,370</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Deposits:		
Noninterest-bearing	\$ 63,055	\$ 61,499
Interest-bearing	650,561	586,511
<b>TOTAL DEPOSITS</b>	<b>713,616</b>	<b>648,010</b>
Short-term borrowings	117,838	105,435
Long-term borrowings	44,055	46,464
Other liabilities	4,290	3,359
<b>TOTAL LIABILITIES</b>	<b>879,799</b>	<b>803,268</b>

Commitments and contingent liabilities

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Stockholders Equity:

Common Stock Authorized 25,000,000 shares; issued 15,468,459 in 2009 and 15,283,520 in 2008	95,163	94,217
Retained earnings	6,249	6,096
Accumulated other comprehensive income (loss)	2,140	2,292
Treasury stock, at cost; 2,053,075 shares in 2009 and 2,053,058 in 2008	(25,503)	(25,503)
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>78,049</b>	<b>77,102</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 957,848</b>	<b>\$ 880,370</b>

See accompanying notes

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

	(In Thousands except Per Share Data)			
	For the Three Months Ended		For the Six Months Ended	
	<b>June 30,</b>	<b>June 30,</b>	<b>June 30,</b>	<b>June 30,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>INTEREST AND DIVIDEND INCOME</b>				
Loans, including fees	\$ 9,357	\$ 8,524	\$ 18,393	\$ 17,142
Taxable securities	2,284	1,955	4,580	3,532
Tax exempt securities	613	705	1,199	1,403
Dividends	67	86	137	229
Federal funds sold	8	77	14	239
<b>TOTAL INTEREST AND DIVIDEND INCOME</b>	<b>12,329</b>	<b>11,347</b>	<b>24,323</b>	<b>22,545</b>
<b>INTEREST EXPENSE</b>				
Deposits	3,133	3,995	6,422	8,167
Short-term borrowings	467	390	972	985
Long-term borrowings	501	569	1,018	1,166
<b>TOTAL INTEREST EXPENSE</b>	<b>4,101</b>	<b>4,954</b>	<b>8,412</b>	<b>10,318</b>
<b>NET INTEREST INCOME</b>	<b>8,228</b>	<b>6,393</b>	<b>15,911</b>	<b>12,227</b>
Provision for loan losses	1,050	100	1,500	210
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>7,178</b>	<b>6,293</b>	<b>14,411</b>	<b>12,017</b>
<b>NONINTEREST INCOME</b>				
Service charges on deposit accounts	653	643	1,252	1,287
Bank owned life insurance income	126	133	257	265
Trust income	1,003	0	1,003	0
Security gains	509	0	509	194
Impairment of equity securities	(74)	(551)	(74)	(551)
Other operating income	426	419	814	844
<b>TOTAL NONINTEREST INCOME</b>	<b>2,643</b>	<b>644</b>	<b>3,761</b>	<b>2,039</b>
<b>NONINTEREST EXPENSES</b>				
Salaries and employee benefits	4,078	2,802	7,098	5,613
Occupancy and equipment	817	733	1,667	1,454
State and local taxes	238	205	451	416
Professional fees	228	143	443	287

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Advertising	155	102	255	223
FDIC insurance	697	17	928	34
Merger related costs	0	0	453	0
Intangible amortization	148	0	148	0
Other operating expenses	1,442	1,093	2,616	2,074
<b>TOTAL NONINTEREST EXPENSES</b>	<b>7,803</b>	<b>5,095</b>	<b>14,059</b>	<b>10,101</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>2,018</b>	<b>1,842</b>	<b>4,113</b>	<b>3,955</b>
<b>INCOME TAXES</b>	<b>361</b>	<b>308</b>	<b>772</b>	<b>697</b>
<b>NET INCOME</b>	<b>\$ 1,657</b>	<b>\$ 1,534</b>	<b>\$ 3,341</b>	<b>\$ 3,258</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:</b>				
Change in net unrealized gains (losses) on securities, net of reclassifications	(944)	(2,889)	(152)	(1,165)
<b>COMPREHENSIVE INCOME (LOSS)</b>	<b>\$ 713</b>	<b>(\$1,355)</b>	<b>\$ 3,189</b>	<b>\$ 2,093</b>
<b>NET INCOME PER SHARE basic and diluted</b>	<b>\$ 0.12</b>	<b>\$ 0.12</b>	<b>\$ 0.25</b>	<b>\$ 0.25</b>
<b>DIVIDENDS PER SHARE</b>	<b>\$ 0.12</b>	<b>\$ 0.12</b>	<b>\$ 0.24</b>	<b>\$ 0.28</b>

See accompanying notes

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

	(In Thousands except Per Share Data)	
	Six Months Ended	
	<b>June 30, 2009</b>	<b>June 30, 2008</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 3,341	\$ 3,258
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	1,500	210
Depreciation and amortization	671	522
Net amortization of securities	170	126
Security gains	(509)	(194)
Impairment of securities	74	551
Federal Home Loan Bank dividends	0	(115)
Increase in bank owned life insurance	(257)	(265)
Net change in other assets and liabilities	22	(1,003)
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>5,012</b>	<b>3,090</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from maturities and repayments of securities available for sale	37,874	31,868
Proceeds from sales of securities available for sale	9,530	6,417
Purchases of securities available for sale	(55,535)	(73,941)
Purchase of trust entity, net	(10,511)	0
Loan originations and payments, net	(42,240)	4,297
Proceeds from sale of other real estate owned	146	43
Additions to premises and equipment	(395)	(311)
<b>NET CASH FROM INVESTING ACTIVITIES</b>	<b>(61,131)</b>	<b>(31,627)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net change in deposits	65,606	40,418
Net change in short-term borrowings	12,403	(10,373)
Proceeds from Federal Home Loan Bank borrowings and other debt	0	5,000
Repayment of Federal Home Loan Bank borrowings and other debt	(2,409)	(7,828)
Repurchase of common stock	0	(493)
Cash dividends paid	(3,189)	(3,648)
Proceeds from dividend reinvestment	946	1,415
<b>NET CASH FROM FINANCING ACTIVITIES</b>	<b>73,357</b>	<b>24,491</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>17,238</b>	<b>(4,046)</b>
Beginning cash and cash equivalents	24,049	31,105



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Ending cash and cash equivalents	\$	41,287	\$	27,059
Supplemental cash flow information:				
Interest paid	\$	8,473	\$	10,482
Income taxes paid	\$	1,165	\$	640

Supplemental noncash disclosures:

Transfer of loans to other real estate	\$	436	\$	113
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Farmers National Banc Corp acquired all of the stock of Butler Wick Trust Company for \$12.13 million on March 31, 2009.

The assets acquired and liabilities assumed are itemized in the Acquisition footnote on page 9 of this report.

See accompanying notes

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

### **Principles of Consolidation:**

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, The Farmers National Bank of Canfield and Farmers Trust Company. All significant intercompany balances and transactions have been eliminated in the consolidation.

### **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 2008 Annual Report to Shareholders included in the Company's 2008 Annual Report on Form 10-K. The interim 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. Management has evaluated events occurring subsequent to the balance sheet date through August 10, 2009 (the final statement issuance date), determining no events require adjustment to or additional disclosure in the consolidated financial statements. 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. The Corporation's chief decision makers monitor the revenue streams of the various products and services, which are all financial in nature.

Quantitative thresholds of SFAS 131, *Disclosures about Segments of an Enterprise and Related Information* are monitored. For the quarter ended June 30, 2009, the reported revenue for Farmers Trust Company was 9.23% of total revenue for Farmers National Banc Corp. Total revenue includes net interest income (before provision for loan losses) plus non-interest income. Net income for Farmers Trust Company for the quarter and year to date period ended June 30, 2009 was 1.23% and .61% of consolidated net income. Total assets of Farmers Trust Company at June 30, 2009 were 1.30% of total assets. Farmers Trust Company does not meet any of the quantitative thresholds of SFAS 131. Accordingly, all the Corporation's banking and trust operations are considered by management to be aggregated in one reportable operating segment.

**Securities:**

The following table summarizes the amortized cost and fair value of the available-for-sale investment securities portfolio at June 30, 2009 and December 31, 2008 and the corresponding amounts of unrealized gains and losses:

(In Thousands of Dollars)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>June 30, 2009</b>				
U.S. government-sponsored entities	\$ 73,106	\$ 952	\$ (711)	\$ 73,347
States and political subdivisions	65,531	562	(1,124)	64,969
Mortgage-backed securities residential	139,102	3,525	(46)	142,581
Collateralized mortgage obligations	408	11	0	419
Equity securities	149	126	(14)	261
Other securities	250	10	0	260
Totals	\$ 278,546	\$ 5,186	\$ (1,895)	\$ 281,837

(In Thousands of Dollars)

**December 31, 2008**

U.S. government-sponsored entities	\$ 42,611	\$ 2,089	\$ (19)	\$ 44,681
States and political subdivisions	61,749	536	(1,379)	60,906
Mortgage-backed securities	163,497	2,722	(397)	165,822
Equity securities	222	34	(60)	196
Totals	\$ 268,079	\$ 5,381	\$ (1,855)	\$ 271,605

The amortized cost and fair value of the debt securities portfolio are shown by contractual maturity. Mortgage-backed and CMO securities are not due at a single maturity date and are shown separately.

(In Thousands of Dollars)	June 30, 2009	
<b>Maturity</b>	Amortized Cost	Fair Value
Within one year	\$ 2,600	\$ 2,634
One to five years	62,741	63,301
Five to ten years	40,938	40,729
Beyond ten years	32,608	31,912
Mortgage-backed and CMO securities	139,510	143,000
Total	\$ 278,397	\$ 281,576

The following table summarizes the investment securities with unrealized losses at June 30, 2009 by aggregated major security type and length of time in a continuous unrealized loss position:

(In Thousands of Dollars)	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>June 30, 2009</b>						
Available-for-sale U.S.						
government- sponsored entities	\$ 34,832	\$ (694)	\$ 502	\$ (17)	\$ 35,334	\$ (711)
States and political	23,831	(600)	4,864	(524)	28,695	(1,124)
Mortgage-backed securities						
residential	274	(28)	2,194	(18)	2,468	(46)
Equity securities	0	0	9	(14)	9	(14)
<b>Total</b>	<b>\$ 58,937</b>	<b>\$ (1,322)</b>	<b>\$ 7,569</b>	<b>\$ (573)</b>	<b>\$ 66,506</b>	<b>\$ (1,895)</b>

Proceeds from sales of securities were \$9.53 million and \$6.42 million for the six months ended June 30, 2009 and 2008, respectively. Gross gains of \$509 thousand and \$194 thousand were realized on these sales during 2009 and 2008, respectively.

Proceeds from sales of securities were \$9.53 million for the three months ended June 30, 2009. Gross gains of \$509 thousand were realized on these sales during 2009. There were no security sales during the three-month period ended June 30, 2008.

#### *Other-Than-Temporary-Impairment*

Management evaluates securities for other-than-temporary impairment ( OTTI ) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities are generally evaluated for OTTI under Statement of Financial Accounting Standards ( SFAS ) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer s financial condition, the Corporation may consider whether the securities are issued by the federal government or its agencies, or U.S. Government sponsored enterprises, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer s financial condition. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis. If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, the OTTI shall be recognized in earnings equal to the entire difference between the investment s amortized cost basis and its fair value at the balance sheet date. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

The Corporation recorded an other-than-temporary pre-tax charge for impairment against local and regional bank holdings in the amount of \$74 thousand, with a related tax benefit of \$26 thousand during the three months ended June 30, 2009.

The Corporation also recorded an other-than-temporary impairment charge against the holdings of Fannie Mae Preferred Stock in the amount of \$551 thousand with a related tax benefit of \$188 thousand during the quarter ended June 30, 2008.



As of June 30, 2009, the Company's security portfolio consisted of 438 securities, 127 of which were in an unrealized loss position. The majority of the unrealized losses on the Corporation's securities are related to its holdings of U.S. Government-sponsored entities and obligations of states and political subdivisions, as discussed below.

Unrealized losses on debt securities issued by the U.S. Government-sponsored entities 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 debt securities at June 30, 2009 on the Corporation's obligations of states and political subdivisions have not been recognized into income because the securities are of high credit quality and management has the intent and ability to hold these until they recover their underlying value which may be at maturity.

**Loans:**

Individually impaired loans were as follows:

(In Thousands of Dollars)	June 30, 2009	December 31, 2008
Loans with no allocated allowance for loan losses	\$ 701	\$ 213
Loans with allocated allowance for loan losses	7,599	2,425
	\$ 8,300	\$ 2,638
Amount of the allowance for loan losses allocated	\$ 2,263	\$ 555

Interest income recognized during impairment for the periods was immaterial.

Nonperforming loans were as follows:

(In Thousands of Dollars)	June 30, 2009	December 31, 2008
Nonaccrual loans:		
Residential real estate	\$ 1,721	\$ 1,484
Commercial real estate	7,955	2,821
Consumer	216	129
Commercial	971	341
Restructured loans	0	0
Loans past due over 90 days still on accrual	315	562
Total nonperforming loans	\$ 11,178	\$ 5,337
Other real estate owned	355	65
Total nonperforming assets	\$ 11,533	\$ 5,402
Percentage of nonperforming loans to loans	1.88%	.97%
Percentage of nonperforming assets to loans	1.94%	.98%
Percentage of nonperforming assets to total assets	1.20%	.61%



The identification of loans as impaired and the valuation of collateral dependent impaired loans is a challenging component of our financial reporting process due to the timing of when a loan is identified as impaired and the need to timely close the Company's books for a given period. Typically, non-homogeneous loans are identified as impaired when they become ninety days past due, or earlier if management believes it is probable that the Company will not collect all amounts due under the terms of the loan agreement. Because the circumstances surrounding loan collection are commonly fluid, we often conclude a loan is impaired relatively late in the financial reporting process. Given this, when we identify a loan as impaired and also conclude that the loan is collateral dependent, we typically perform an internal collateral valuation as an interim measure to facilitate the closing of the Company's books. We typically obtain an external appraisal to validate our internal collateral valuation as soon as is practical. To the extent that an external appraisal returns a value estimate that is materially different from our internally generated estimate before the release of our interim or annual financial statements, we would adjust the associated specific loss reserve and, if necessary, the Company's consolidated financial statements for the difference.

### 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,		Six months ended June 30,	
	2009	2008	2009	2008
<b>Basic EPS computation</b>				
Numerator Net income	\$ 1,657	\$ 1,534	\$ 3,341	\$ 3,258
Denominator Weighted average shares outstanding	13,339,289	13,088,891	13,285,768	13,053,483
<b>Basic earnings per share</b>	\$ .12	\$ .12	\$ .25	\$ .25
<b>Diluted EPS computation</b>				
Numerator Net income	\$ 1,657	\$ 1,534	\$ 3,341	\$ 3,258
Denominator Weighted average shares outstanding for basic earnings per share	13,339,289	13,088,891	13,285,768	13,053,483
Effect of Stock Options	0	0	0	0
Weighted averages shares for diluted earnings per share	13,339,289	13,088,891	13,285,768	13,053,483
<b>Diluted earnings per share</b>	\$ .12	\$ .12	\$ .25	\$ .25

Stock options for 39,500 and 42,500 shares were not considered in the computing of diluted earnings per share for 2009 and 2008 respectively because they were antidilutive.



**Stock Based Compensation:**

The Corporation's Stock Option Plan, which is shareholder-approved, permits the grant of share options to its directors, officers and employees for up to 375,000 shares of common stock. Option awards are generally granted with an exercise price equal to the market price of the Corporation's common stock at the date of grant, those option awards have vesting periods of 5 years and have 10-year contractual terms. At June 30, 2009 there were 39,500 outstanding options of which 34,500 are fully vested and exercisable.

The fair value of each option award is estimated on the date of grant using the Black-Scholes model. Total compensation cost charged against income for the stock option plan for the quarter ended June 30, 2009 was not material. No related income tax benefit was recorded.

**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.

**Acquisition:**

On March 31, 2009, the Corporation completed its acquisition of Butler Wick Trust Company, a wholly owned subsidiary of Butler Wick Corp. Farmers National Banc Corp acquired the capital stock of Butler Trust for cash in the amount of \$12.125 million, subject to certain adjustments contained in the stock purchase agreement.

The following table summarizes the estimated fair value of assets acquired and liabilities assumed at the date of the acquisition:

Cash and due from banks	\$ 1,614
Securities available for sale	2,071
Premises and equipment	44
Goodwill	3,679
Other intangible assets	4,240
Other assets	746
 Total assets acquired	 12,394
 Liabilities assumed	 (269)
 Net assets acquired	 \$ 12,125

**Recent Accounting Pronouncements**

In April 2009, the FASB issued Staff Position (FSP) No. 115-2 and No. 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which amends existing guidance for determining whether impairment is other-than-temporary (OTTI) for debt securities. The FSP requires an entity to assess whether it intends to sell, or it is more likely than not that it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized in earnings. For securities that do not meet the aforementioned criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income. Additionally, the FSP expands and increases the frequency of existing disclosures about other-than-temporary impairments for debt and equity securities. This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Through the period ended March 31, 2009, the Corporation had not recognized any other-than-temporary impairment charges on debt securities. The adoption of this FSP on April 1, 2009 did not have a material impact on the results of operations or financial position.



In April 2009, the FASB issued Staff Position (FSP) No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset and Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. This FSP emphasizes that even if there has been a significant decrease in the volume and level of activity, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants. The FSP provides a number of factors to consider when evaluating whether there has been a significant decrease in the volume and level of activity for an asset or liability in relation to normal market activity. In addition, when transactions or quoted prices are not considered orderly, adjustments to those prices based on the weight of available information may be needed to determine the appropriate fair value. The FSP also requires increased disclosures. This FSP is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. The adoption of this FSP at June 30, 2009 did not have a material impact on the results of operations or financial position.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. This FSP amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies that were previously only required in annual financial statements. This FSP is effective for interim reporting periods ending after June 15, 2009. The adoption of this FSP at June 30, 2009 did not have a material impact on the results of operations or financial position as it only required disclosures which are included in the Fair Value Note.

In December 2007, the FASB issued FAS No. 141 (revised 2007), *Business Combinations* ( FAS 141(R) ), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. FAS No. 141(R) is effective for fiscal years beginning on or after December 15, 2008. During March 2009, the Corporation acquired Butler Wick Trust Company, and the principles and requirements of FAS 141(R) were used to account for the combination.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51* ( SFAS No. 160 ), which will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity within the consolidated balance sheets. FAS No. 160 is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. The impact of adoption was not material.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, an amendment of SFAS No. 133. FAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 for derivative instruments and hedging activities. FAS No. 161 requires qualitative disclosure about objectives and strategies for using derivative and hedging instruments, quantitative disclosures about fair value amounts of the instruments and gains and losses on such instruments, as well as disclosures about credit-risk features in derivative agreements. FAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of this standard did not have a material effect on the Corporation's results of operations or financial position.

**Recently Issued but not yet Effective Accounting Pronouncements:**

**Accounting for Transfers of Financial Assets:** In June 2009, FASB issued SFAS No. 166 Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140. The objective of SFAS No. 166 is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. SFAS No. 166 shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Management is still evaluating the impact of this accounting standard.

**Amendments to FASB Interpretation No. 46(R):** In June 2009, FASB issued SFAS No. 167 Amendments to FASB Interpretation No. 46(R). The objective of SFAS No. 167 is to amend certain requirements of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. SFAS No. 167 shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. Management is still evaluating the impact of this accounting standard.

**Fair Value**

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS No. 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing and asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

**Investment Securities :** The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

Impaired Loans : The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

(In Thousands of Dollars)	Carrying Value	Fair Value Measurements at June 30, 2009 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial Assets</b>				
Investment securities available-for sale				
U.S. government-sponsored entities and agencies	\$ 73,347	\$ 0	\$ 73,347	\$ 0
States and political subdivisions	64,969	0	64,969	0
Mortgage-backed securities-residential	142,581	0	142,565	16
Collateralized mortgage obligations	419	0	419	0
Equity securities	261	261	0	0
Other securities	260	0	260	0
<b>Total investment securities</b>	<b>\$ 281,837</b>	<b>\$ 261</b>	<b>\$ 281,560</b>	<b>\$ 16</b>

(In Thousands of Dollars)	Carrying Value	Fair Value Measurements at December 31, 2008 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial Assets</b>				
Investment securities available-for sale				
	\$ 271,605	\$ 196	\$ 262,432	\$ 8,977

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The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three month and six month periods ended June 30, 2009:

	Investment Securities Available-for-sale
Three months ended June 30, 2009	
Balance of recurring Level 3 assets at April 1, 2009	\$ 8,598
Total unrealized gains or losses:	
Included in other comprehensive income	0
Purchases, sales, issuances and settlements, net	(1,610)
Transfers in and/or out of Level 3	(6,972)
Balance of recurring Level 3 assets at June 30, 2009	\$ 16

	Investment Securities Available-for-sale
Six months ended June 30, 2009	
Balance of recurring Level 3 assets at January 1, 2009	\$ 8,977
Total unrealized gains or losses:	
Included in other comprehensive income	(379)
Purchases, sales, issuances and settlements, net	(1,610)
Transfers in and/or out of Level 3	(6,972)
Balance of recurring Level 3 assets at June 30, 2009	\$ 16

Assets measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at June 30, 2009 Using: Significant		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(In Thousands of Dollars)			
Impaired loans	0	0	\$ 5,336

Fair Value Measurements at  
December 31, 2008 Using:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant	
		Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(In Thousands of Dollars)			

Impaired loans	0	0	\$ 1,870
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Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a recorded investment amount of \$7.60 million, with a valuation allowance of \$2.26 million, resulting in an additional provision for loan losses of \$1.16 million for the three month period ended June 30, 2009 and \$1.71 million for the six month period ended June 30, 2009.

In accordance with FSP FAS 107-1, the carrying amounts and estimated fair values of financial instruments, at June 30, 2009 are as follows:

(In Thousands of Dollars) <b>June 30, 2009</b>	Carrying Amount	Fair Value
Financial assets		
Cash and cash equivalents	\$ 41,287	\$ 41,287
Securities available-for-sale	281,837	281,837
Restricted stock	5,317	n/a
Loans, net	586,756	599,682
Accrued interest receivable	4,091	4,091
Financial liabilities		
Deposits	713,616	718,972
Short-term borrowings	117,838	117,838
Long-term borrowings	44,055	46,173
Accrued interest payable	1,260	1,260

The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, interest bearing deposits, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities were described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of restricted stock due to restrictions placed on its transferability. The fair value of off-balance-sheet items is not considered material (or is based on the current fees or cost that would be charged to enter into or terminate such arrangements).



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Forward Looking Statements

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

### Overview

The Corporation's strategies are to continue our growth initiatives and increase earnings; maintain the appropriate levels of capital that are essential so that we remain a well-capitalized institution under all regulatory guidelines; continue to deal with the number of issues the banking industry has been facing; closely monitor our efficiency ratio; and strategically manage interest rate risk and credit risk, specifically, the non-performing assets.

### Results of Operations

Comparison of selected financial ratios and other results at or for the three-month and six-month periods ending June 30, 2009 and 2008:

(Dollars in Thousands, except Per Share Data)	At or for Three months Ended June 30,		At or for Six months Ended June 30,	
	2009	2008	2009	2008
Total Assets	\$ 957,848	\$ 824,513	\$ 957,848	\$ 824,513
Net Income	\$ 1,657	\$ 1,534	\$ 3,341	\$ 3,258
Basic and Diluted Earnings per share	\$ .12	\$ .12	\$ .25	\$ .25
Return on Average Assets (Annualized)	.70%	.74%	.73%	.80%
Return on Average Equity (Annualized)	8.43%	8.16%	8.54%	8.73%
Efficiency Ratio (tax equivalent basis)	70.11%	62.94%	68.90%	64.55%
Equity to Asset Ratio	8.15%	8.89%	8.15%	8.89%
Dividends to Net Income	96.62%	102.35%	95.45%	111.97%
Net Loans to Assets	61.26%	61.13%	61.26%	61.13%
Loans to Deposits	83.15%	80.38%	83.15%	80.38%

Despite the challenging economic environment, the Corporation was able to achieve favorable success in key areas and the business model continues to gain momentum with another period of strong organic growth. The net earnings were impacted negatively during the first six months of the year by the extraordinary FDIC insurance premium expense that all FDIC insured banks incurred this year along with the ongoing challenge towards credit quality and loan losses. Commercial lenders and personal bankers have given lift to the business model during the first six-month period of 2009, as they continue to originate new loans and attract new core deposit relationships. The net interest income, which is the primary source of revenue for the Corporation increased 30.1% over the same six-month period in 2008. The Corporation will focus on continued growth through organic means as well as manage interest rate risk and credit risk.

The acquisition of Butler Wick Trust Company (Farmers Trust Company) gives the Corporation the ability to provide investment, trust, and estate services to private individuals and small corporate clients with a high level of attention

and confidentiality. The combination of Farmers and Butler Wick Trust Company represents a win-win for the respective organizations. The addition to Farmers National Bank significantly complements core retail banking and asset management.

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.

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

	Three Months Ended June 30, 2009			Three Months Ended June 30, 2008		
	AVERAGE		RATE (1)	AVERAGE		RATE (1)
	BALANCE	INTEREST		BALANCE	INTEREST	
<b>EARNING ASSETS</b>						
Loans (3) (5) (6)	\$ 570,214	\$ 9,490	6.68%	\$ 503,042	\$ 8,605	6.88%
Taxable securities (4)	213,060	2,284	4.30	177,804	1,955	4.42
Tax-exempt securities (4) (6)	61,002	917	6.03	71,900	1,055	5.90
Equity Securities (2) (6)	5,539	67	4.85	8,235	92	4.49
Federal funds sold	30,097	8	0.11	15,301	77	2.02
Total earning assets	879,912	12,766	5.82	776,282	11,784	6.11
<b>NON-EARNING ASSETS</b>						
Cash and due from banks	22,948			22,680		
Premises and equipment	14,122			14,436		
Allowance for Loan Losses	(5,992)			(5,492)		
Unrealized gains (losses) on securities	6,119			912		
Other assets (3)	36,304			20,803		
Total Assets	\$ 953,413			\$ 829,621		
<b>INTEREST-BEARING LIABILITIES</b>						
Time deposits	\$ 302,435	\$ 2,386	3.16%	\$ 293,525	\$ 3,194	4.38%
Savings deposits	233,097	668	1.15	180,446	688	1.53
Demand deposits	102,026	79	0.31	98,167	113	0.46
Short term borrowings	126,773	467	1.48	65,642	390	2.39
Long term borrowings	44,292	501	4.54	49,957	569	4.58
Total Interest-Bearing Liabilities	808,623	4,101	2.03	687,737	4,954	2.90
<b>NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS EQUITY</b>						
Demand deposits	61,510			62,650		
Other Liabilities	4,441			3,813		
Stockholders equity	78,839			75,421		

Total Liabilities and Stockholders Equity	\$ 953,413		\$ 829,621	
Net interest income and interest rate spread	\$ 8,665	3.79%	\$ 6,830	3.21%
Net interest margin		3.95%		3.54%
(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) Includes unamortized discounts and premiums. Average balance and yield are computed using the average historical amortized cost.				
(5) Interest on loans includes fee income of \$670 thousand and \$459 thousand for 2009 and 2008 respectively and is reduced by				

amortization of  
\$363 thousand  
and \$265  
thousand for  
2009 and 2008  
respectively.

- (6) For 2009,  
adjustments of  
\$133 thousand  
and \$304  
thousand  
respectively are  
made to tax  
equate income  
on tax exempt  
loans and tax  
exempt  
securities. For  
2008,  
adjustments of  
\$81 thousand,  
\$350 thousand,  
and \$6 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.

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

	Six Months Ended June 30, 2009			Six Months Ended June 30, 2008		
	AVERAGE		RATE (1)	AVERAGE		RATE (1)
	BALANCE	INTEREST		BALANCE	INTEREST	
<b>EARNING ASSETS</b>						
Loans (3) (5) (6)	\$ 562,376	\$ 18,618	6.68%	\$ 505,455	\$ 17,305	6.88%
Taxable securities (4)	209,681	4,580	4.44	163,605	3,532	4.34
Tax-exempt securities (4) (6)	60,012	1,795	6.03	71,637	2,101	5.90
Equity Securities (2) (6)	5,540	137	4.99	8,207	256	6.27
Federal funds sold	23,882	14	0.12	18,647	239	2.58
Total earning assets	861,491	25,144	5.89	767,551	23,433	6.14
<b>NON-EARNING ASSETS</b>						
Cash and due from banks	22,696			22,755		
Premises and equipment	14,128			14,445		
Allowance for Loan Losses	(5,844)			(5,489)		
Unrealized gains (losses) on securities	5,305			696		
Other assets (3)	30,993			20,730		
Total Assets	\$ 928,769			\$ 820,688		
<b>INTEREST-BEARING LIABILITIES</b>						
Time deposits	\$ 295,817	\$ 4,855	3.31%	\$ 289,677	\$ 6,518	4.53%
Savings deposits	224,768	1,385	1.24	171,855	1,413	1.65
Demand deposits	100,325	182	0.37	97,216	236	0.49
Short term borrowings	113,360	972	1.73	70,021	985	2.83
Long term borrowings	48,755	1,018	4.21	51,048	1,166	4.59
Total Interest-Bearing Liabilities	783,025	8,412	2.17	679,817	10,318	3.05
<b>NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS EQUITY</b>						
Demand deposits	62,250			60,996		
Other Liabilities	4,584			4,855		
Stockholders equity	78,910			75,020		

Total Liabilities and Stockholders' Equity	\$ 928,769		\$ 820,688	
Net interest income and interest rate spread	\$ 16,732	3.72%	\$ 13,115	3.09%
Net interest margin		3.93%		3.44%

- (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) Includes unamortized discounts and premiums. Average balance and yield are computed using the average historical amortized cost.
- (5) Interest on loans includes fee income of \$1.290 million and \$799 thousand for 2009 and 2008 respectively and is reduced by amortization of

\$698 thousand and \$532 thousand for 2009 and 2008 respectively.

- (6) For 2009, adjustments of \$225 thousand and \$596 thousand respectively are made to tax equate income on tax exempt loans and tax exempt securities. For 2008, adjustments of \$163 thousand, \$698 thousand, and \$27 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.



**Taxable equivalent net interest income.** Taxable equivalent net interest income for the first six months ended June 30, 2009 totaled \$16.73 million, an increase of \$3.62 million or 27.58% compared to the first six months of 2008. Although the yield on earning assets decreased by 25 basis points over the past 12 months, the net interest margin benefited from a 88 basis point decrease in the cost of interest-bearing liabilities, resulting in an overall 49 basis point increase in the net interest margin. Average savings deposits increased by \$52.91 million or 30.79% over the prior year six-month period as customers continue to move investment dollars from the equity markets seeking liquidity and security. Short term borrowings increased \$43.34 million over the same period in the prior year as a result of repurchase agreements increasing \$54.03 million. Although these average savings deposits and short term borrowings increased, interest expense related to these items actually decreased by \$41 thousand or 1.71% over that same period. Taxable equivalent net interest income for the quarter ended June 30, 2009 totaled \$8.67 million, an increase of \$1.84 million or 26.87% compared to the quarter ended June 30, 2008. The yield on earning assets decreased by 29 basis points and the cost of interest-bearing liabilities decreased by 87 basis points over the past 12 months to positively impact the net interest margin. The net interest margin has made improvement over the prior period as management has made an increased effort to control the cost of funds. The Corporation's balance sheet is liability sensitive and in the current market of lower interest rates the liabilities are repricing faster than assets. This trend is expected to slow and reverse once interest rates begin to move upward.

**Noninterest Income.** Total noninterest income for the six-month period ended June 30, 2009 increased by \$1.72 million or 84.45% compared to the same period in 2008. This increase is due to an increase of \$315 thousand in security gains, a reduction of \$477 thousand in impairment charges, and \$1.00 million of trust income from the newly acquired entity. Excluding these three items the non-interest income was \$2.32 million during the first six months of 2009 compared to \$2.40 million in 2008, a decrease of 3.05%.

Total noninterest income for the three-month period ended June 30, 2009 increased by \$2.00 million or 310.40% compared to the same period in 2008. This increase is due to the same items that caused the increase over the six-month period. Impairment charges were down \$477 thousand, security gains were up \$509 thousand, and the newly acquired trust company supplied \$1.00 million to bolster the noninterest income. Excluding these items, noninterest income was up \$10 thousand for the second quarter of 2009 compared to the same quarter in 2008.

**Noninterest Expense.** Noninterest expense was \$14.06 million for the first six months of 2009 compared to \$10.10 million for the same period in 2008. This amounts to an increase of \$3.96 million or 39.18% and was mainly the result of an increase of \$1.49 million in salaries and employee benefits, \$894 thousand in FDIC insurance, \$453 thousand in merger costs and \$148 thousand in amortization associated with the Trust Company acquisition. Of the \$1.49 million increase in salaries and employee benefits \$489 thousand can be attributed to salary and temporary wages and \$215 thousand to employee health insurance.

Noninterest expense was \$7.80 million for the quarter ended June 30, 2009 compared to \$5.10 million for the same period in 2008. This is an increase of \$2.71 million or 53.15%. For the second quarter of 2009, the Corporation experienced a \$1.28 million increase in salary and employee benefits and a \$680 thousand increase in FDIC insurance costs.

Below is a detail of non-interest expense line items classified between the total Corporation, the Corporation without Trust and the Trust for the three month period ending June 30, 2009. The Corporation purchased the Trust Company on March 31, 2009; therefore, information is not presented for the six month period.

(In Thousands of Dollars)	For the Three Months Ended June 30, 2009		
	Total Corporation	Corporation without Trust	Trust
Noninterest expense			
Salaries and employee benefits	\$ 4,078	\$ 3,452	\$ 626
Occupancy and equipment	817	768	49
State and local taxes	238	223	15
Professional fees	228	213	15
Advertising	155	151	4
FDIC insurance	697	697	0
Merger related costs	0	0	0
Intangible amortization	148	0	148
Other operating expenses	1,442	1,276	166
Total noninterest expense	\$ 7,803	\$ 6,780	\$ 1,023

The efficiency ratio increased to 68.90% for the first six months of 2009 compared to 64.55% for the first six months of 2008. The ratio was negatively impacted by the merger expenses and FDIC insurance expenses mentioned above. The efficiency ratio is calculated as follows: non-interest expense, excluding intangible amortization, 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 \$772 thousand for the first six months of 2009 and \$697 thousand for the first six months of 2008. The effective tax rate for the first six months of 2009 was 18.77% compared to 17.62% for the same time period in 2008. The effective tax rate is higher for the current six month period due to the \$11.63 million reduction in the average balance of tax exempt securities compared to June 30, 2008.

Income tax expense totaled \$361 thousand for the quarter ended June 30, 2009 and \$308 thousand for the quarter ended June 30, 2008, an increase of 17.21%. The increase can be attributed to the reduction in tax exempt municipal securities and the increase in income before taxes.

**Other Comprehensive Income.** For the first six months of 2009, the change in net unrealized gains on securities, net of reclassifications, resulted in an unrealized loss, net of tax of \$152 thousand compared to an unrealized loss of \$1.17 million for the same period in 2008. The quarter ended June 30, 2009 had an unrealized loss on securities of \$944 thousand compared to an unrealized loss of \$2.89 million for the same six month period in 2008. With an unrealized gain recorded at June 30, 2009 of \$2.14 million, management believes the decrease in fair value during the first six months and second quarter periods of 2009 is largely due to recognition of security gains through the income statement and normal market changes.

## Financial Condition

Total assets increased \$77.48 million or 8.80% since December 31, 2008, as the Corporation also experienced an increase in deposit balances. Capital ratios remain strong, as shown by the ratio of equity to total assets at June 30, 2009 of 8.15%.

**Securities.** Securities available-for-sale increased by \$10.23 million. Security purchases of \$55.5 million were funded by maturing securities of \$37.87 million and the \$65.61 million increase in deposits. The Corporation sold \$9.53 million in market value of available-for-sale securities, resulting in a gain of \$509 thousand during the second quarter of 2009. There was a \$235 thousand decrease in the net unrealized gains on securities during the first six months of 2009.

**Loans.** Gross loans increased \$41.39 million since December 31, 2008. Indirect installment loans accounted for \$25.83 million of the increase in gross loans as management continues to target the automobile dealers network as a means to diversify the loan portfolio. On a fully tax equivalent basis, loans contributed 74.05% of total interest income for the six months ended June 30, 2009 and 73.85% for the same period in 2008.

**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)

	6/30/09	3/31/09	12/31/08	9/30/08	6/30/08
Nonperforming loans	\$ 11,178	\$ 9,593	\$ 5,337	\$ 3,088	\$ 2,879
Nonperforming loans as a % of total loans	1.88%	1.68%	.97%	.58%	.57%
Allowance for loan losses	\$ 6,640	\$ 5,835	\$ 5,553	\$ 5,433	\$ 5,487
Allowance for loan losses as a % of loans	1.12%	1.02%	1.01%	1.03%	1.08%
Allowance for loan losses as a % of nonperforming loans	59.40%	60.83%	104.05%	175.94%	190.59%

For the six months ended June 30, 2009, management provided \$1.50 million to the allowance for loan losses, an increase of \$1.29 million over the same period in 2008. The allowance for loan losses as a percentage of loans increased from 1.01% at December 31, 2008 to 1.12% at June 30, 2009. Net charge-offs totaled \$413 thousand for the first six months of 2009 up from \$183 thousand for the first six months of 2008. During 2009, approximately 53.34% of gross charge-offs have occurred in the indirect loan portfolio compared to 65.58% in 2008.

The ratio of nonperforming loans to total loans increased from .97% at December 31, 2008 to 1.88% at June 30, 2009. As of June 30, 2009, total non-performing loans were \$11.18 million, compared to \$5.34 million at the end of 2008. The ratio of the allowance for loan losses (ALLL) to non-performing loans at June 30, 2009 was 59.40%, compared to 104.05% at December 31, 2008. The increase in non-performing loans is primarily due to the classification of certain commercial real estate and land development loans that are in default according to the terms of the contract. A significant allocation in our allowance for loan losses is for performing commercial and commercial real estate loans classified by our internal loan review as substandard. Substandard loans are those that exhibit one or more structural weaknesses and there is a distinct possibility that the Bank will suffer a loss on the loan unless the weakness is corrected. The allocation for these loans was \$1.83 million at June 30, 2009 and \$2.16 million at December 31, 2008. The allocation decreased due to a reduction in the balance of these loans. Our actual loss experience may be more or less than the amount allocated. Additionally, our allowance for loan losses includes an allocation for loans specifically identified as impaired under Statement of Financial Accounting Standards No. 114. At June 30, 2009, loans considered to be impaired totaled \$8.30 million with an allowance allocation of \$2.26 million. At the end of 2008, loans considered to be impaired were \$2.64 million with an allowance allocation of \$555 thousand. The allowance allocation for these loans is generally based on management's estimate of the fair value of the collateral securing these loans. The amount ultimately charged-off for this relationship may be different from the loss allocation as collateral may be liquidated for amounts different from management's estimates. As always, management is working to address

weaknesses in each of these specific loans that may result in loss.

Based on the evaluation of the adequacy of the allowance for loan losses, management believes that the allowance for loan losses at June 30, 2009 to be adequate and reflects probable incurred losses in the portfolio. 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 increased \$65.61 million since December 31, 2008. Balances in the Corporation's time deposits increased \$33.34 million or 11.79% between December 31, 2008 and June 30, 2009. The majority of the increase in the time deposits was in certificates of deposit which increased \$24.18 million or 10.70% between December 31, 2008 and June 30, 2009. Money market accounts increased \$20.14 million or 15.41% since December 31, 2008 as customers continue to move investment dollars from the equity markets seeking liquidity and security. The Company continues to price deposit rates to remain competitive within the market and to retain customers.

**Borrowings.** Total borrowings increased \$9.99 million or 6.58% since December 31, 2008. The increase in borrowings is due to the increase in securities sold under repurchase agreements, which increased \$33.16 million, offset by a decrease in Federal Home Loan Bank Advances of \$22.38 million during the first six months of 2009. The large increase in repurchase agreements is the result of an increase in local public funds deposits.

**Capital Resources.** Total stockholders' equity increased from \$77.10 million at December 31, 2008 to \$78.05 million at June 30, 2009. During the first six months of 2009, the mark to market adjustment of securities decreased accumulated other comprehensive income by \$152 thousand and overall retained earnings increased by \$153 thousand.

The capital management function is a regular process that consists of providing capital for both the current financial position and the anticipated future growth of the Corporation. As of June 30, 2009 the Corporation's total risk-based capital ratio stood at 12.04%, and the Tier I risk-based capital ratio and Tier I leverage ratio were at 10.96% and 7.40%, respectively. Management believes that the Corporation and Bank meet all capital adequacy requirements to which they are subject, as of June 30, 2009.

#### **Critical Accounting Policies**

The Corporation 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 2008 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 Corporation 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 2008 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 Corporation'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 Corporation 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 Corporation are originating loans and purchasing securities. During the first six months of 2009, net cash used in investing activities amounted to \$61.13 million compared to \$31.63 million used in investing activities for the same period in 2008. The purchase of the new trust entity amounted to \$10.51 million in 2009. Net loans increased by \$42.24 million during this year's first six-month period and decreased \$4.30 million during the same period in 2008. The increases in net loans during 2009 can be attributed to the increased portfolio of indirect installment loans.

The primary financing activities of the Corporation are obtaining deposits, repurchase agreements and other borrowings. Net cash provided by financing activities amounted to \$73.36 million for the first six months of 2009 compared to \$24.49 million provided by financing activities for the same period in 2008. Most of this change is a result of the net increase in deposits, which provided \$65.61 million compared to \$40.42 million provided in financing activities in the first six-month period of 2008.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Corporation'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 Corporation 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 Corporation. Additionally, the Corporation's balance sheet is currently liability sensitive and in the low interest rate environment that exists today, the Corporation's net interest margin should maintain current levels throughout the near future.

The Corporation considers the primary market exposure to be interest rate risk. Simulation analysis is used to monitor the Corporation's exposure to changes in interest rates, and the effect of the change to net interest income. The following table shows the effect on net interest income and the net present value of equity in the event of a sudden and sustained 200 basis point increase or decrease in market interest rates:

<b>Changes In Interest Rate (basis points)</b>	<b>June 30, 2009 Result</b>	<b>December 31, 2008 Result</b>	<b>ALCO Guidelines</b>
Net Interest Income Change			
+200	-4.30%	-5.66%	15.00%
-200	-2.90%	2.11%	15.00%
Net Present Value Of Equity Change			
+200	-8.16%	-7.41%	20.00%
-200	-15.47%	-7.35%	20.00%

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, 2009 amounts as a base case, and considering the increase in deposit liabilities, and the volatile financial markets, the Corporation's change in net interest income would still be within the board mandated limits.

The analysis of the change in the net present value of equity in the event of a 200 basis point decrease in market rates shows a 15.47% decline at June 30, 2009 compared to a 7.35% decline at December 31, 2008. Management does not feel that a 200 basis point decline in the current interest rate environment is likely to occur, and the Corporation would not risk a change to its well capitalized classification.

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

(a) Farmers National Banc Corp's annual meeting of shareholders was held on April 23, 2009.

(b & c) Proxies were solicited by Farmers National Banc Corp's management pursuant to Regulation 14 under the Securities Exchange Act of 1934.

Elected to serve as director for a three year term were the Board of Director's nominees:

<b>Elected Director</b>	<b>Votes For</b>	<b>Votes Against</b>
Benjamin R. Brown	8,833,375	257,847
Anne F. Crawford	8,827,193	264,579
James R. Fisher	8,798,990	280,737

<b>Continuing Director</b>	<b>Term Expiring</b>
Ralph D. Macali	April 2010
Frank L. Paden	April 2010
Earl R. Scott	April 2010
Joseph D. Lane	April 2011
Ronald V. Wertz	April 2011

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

In the opinion of management there are no outstanding legal actions that will have a material adverse effect on the Corporation's financial condition or results of operations.

#### **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, 2008. See also, Forward-Looking Statements included in Part 1, Item 2 of this Quarterly Report on Form 10-Q. In addition to the risk factors identified in the Form 10-K at December 31, 2008 the following risk factor is presented at March 31, 2009:

*Increases in FDIC insurance premiums may have a material adverse affect on our earnings.*

During 2008, there were higher levels of bank failures which dramatically increased resolution costs of the Federal Deposit Insurance Corporation ( FDIC ) and depleted the deposit insurance fund. In order to maintain a strong funding position and restore reserve ratios of the deposit insurance fund, the FDIC voted on December 16, 2008 to increase assessment rates of insured institutions uniformly by 7 basis points (7 cents for every \$100 of deposits), beginning with the first quarter of 2009. Additional changes beginning April 1, 2009, were to require riskier institutions to pay a larger share of premiums by factoring in rate adjustments based on secured liabilities and unsecured debt levels.

As part of the 2008 changes, the FDIC instituted two temporary programs effective through December 31, 2009 to further insure customer deposits at FDIC-member banks: deposit accounts are now insured up to \$250,000 per customer (up from \$100,000) and non-interest bearing transactional accounts are fully insured (unlimited coverage). During 2009, the FDIC imposed a special assessment of 10 additional basis points (10 cents for every \$100 of deposits) on insured institutions on June 30, 2009, to be collected on September 30, 2009. The interim rule would also permit the FDIC to impose an additional emergency special assessment between June 30, 2009 and December 31, 2009. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there is additional bank or financial institution failures, we may be required to pay even higher FDIC premiums than the recently increased levels. These announced increases and any future increases in FDIC insurance premiums may materially adversely affect our results of operations.

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

**Purchases of equity securities by the issuer.**

On July 14, 2009, the Corporation announced the adoption of a stock repurchase program that authorizes the repurchase of up to 4.9% or approximately 657 thousand shares of its outstanding common stock in the open market or in privately negotiated transactions. This program expires in July 2010.

There was no treasury stock purchased by the issuer during the second quarter of 2009.

**Item 3. Defaults Upon Senior Securities**

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.
- 10.1 Letter Agreement, dated July 22, 2008, between Farmers National Bank of Canfield (the Bank), and John S. Gulas (Incorporated herein by reference to Exhibit 10.1 to the Bank's July 22, 2008 Form 8-K).
- 10.2 Letter Agreement, dated December 23, 2008, between Farmers National Bank of Canfield (the Bank), and Kevin J. Helmick (Incorporated herein by reference to Exhibit 10.2 to the Bank's December 23, 2008 Form 8-K).
- 10.3 Letter Agreement, dated December 23, 2008, between Farmers National Bank of Canfield (the Bank), and Mark L. Graham (Incorporated herein by reference to Exhibit 10.3 to the Bank's December 23, 2008 Form 8-K).
- 10.4 Letter Agreement, dated December 23, 2008, between Farmers National Bank of Canfield (the Bank), and Frank L. Paden (Incorporated herein by reference to Exhibit 10.4 to the Bank's December 23, 2008 Form 8-K).
- 10.5 Letter Agreement, dated December 23, 2008, between Farmers National Bank of Canfield (the Bank), and Carl D. Culp (Incorporated herein by reference to Exhibit 10.5 to the Bank's December 23, 2008 Form 8-K).
- 10.6 Certified Resolution regarding Adoption of Farmers National Banc Corp 1999 Stock Option Plan, (Incorporated herein by reference to Exhibit 10.6 to Farmers National Banc Corp's Proxy dated February 24, 1999).
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)

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 10, 2009

/s/ Frank L. Paden

Frank L. Paden  
President and Secretary

Dated: August 10, 2009

/s/ Carl D. Culp

Carl D. Culp  
Executive Vice President and Treasurer

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