FARMERS NATIONAL BANC CORP /OH/
Form 10-Q
August 09, 2010

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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 June 30, 2010 **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 þ No o

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 o No o

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 o Accelerated filer þ Non-accelerated filer o Smaller reporting company o

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

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

Class	Outstanding at July 31, 2010
Common Stock, No Par Value	13,576,880 shares

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

	(In Thousands of Dollars) June 30, 2010	December 31, 2009
ASSETS		
Cash and due from banks	$ 25,767	$ 25,713
Federal funds sold	9,871	25,447
TOTAL CASH AND CASH EQUIVALENTS	35,638	51,160
Securities available for sale	324,681	309,368
Loans	613,259	609,395
Less allowance for loan losses	8,255	7,400
NET LOANS	605,004	601,995
Premises and equipment, net	14,304	14,193
Bank owned life insurance	11,695	11,438
Goodwill	3,709	3,709
Other intangibles	3,501	3,791
Other assets	16,272	19,154
TOTAL ASSETS	$ 1,014,804	$ 1,014,808
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Noninterest-bearing	$ 70,049	$ 68,420
Interest-bearing	690,630	709,132
TOTAL DEPOSITS	760,679	777,552
Short-term borrowings	137,911	125,912
Long-term borrowings	25,280	27,169
Other liabilities	3,943	3,547
TOTAL LIABILITIES	927,813	934,180
Commitments and contingent liabilities		

Stockholders Equity:		
Common Stock Authorized 25,000,000 shares; issued 15,630,007 in 2010 and 15,572,703 in 2009	95,890	95,650
Retained earnings	9,205	7,137
Accumulated other comprehensive income (loss)	7,399	3,344
Treasury stock, at cost; 2,053,127 shares in 2010 and 2,053,098 in 2009	(25,503)	(25,503)
TOTAL STOCKHOLDERS EQUITY	86,991	80,628
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 1,014,804	$ 1,014,808

See accompanying notes

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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	
	June 30, 2010	**June 30, 2009**	**June 30, 2010**	**June 30, 2009**
INTEREST AND DIVIDEND INCOME				
Loans, including fees	$ 9,192	$ 9,357	$ 18,424	$ 18,393
Taxable securities	2,261	2,284	4,502	4,580
Tax exempt securities	584	613	1,175	1,199
Dividends	47	67	100	137
Federal funds sold	15	8	24	14
TOTAL INTEREST AND DIVIDEND INCOME	12,099	12,329	24,225	24,323
INTEREST EXPENSE				
Deposits	2,420	3,133	5,165	6,422
Short-term borrowings	234	467	519	972
Long-term borrowings	269	501	551	1,018
TOTAL INTEREST EXPENSE	2,923	4,101	6,235	8,412
NET INTEREST INCOME	9,176	8,228	17,990	15,911
Provision for loan losses	1,600	1,050	4,378	1,500
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,576	7,178	13,612	14,411
NONINTEREST INCOME				
Service charges on deposit accounts	497	653	975	1,252
Bank owned life insurance income	131	126	257	257
Trust income	1,197	1,003	2,429	1,003
Security gains (losses)	(3)	509	(3)	509
Impairment of equity securities	0	(74)	0	(74)
Insurance agency commissions	110	0	172	0
Investment commissions	129	73	240	144
Other operating income	660	353	987	670
TOTAL NONINTEREST INCOME	2,721	2,643	5,057	3,761
NONINTEREST EXPENSES				
Salaries and employee benefits	4,099	4,078	8,076	7,098
Occupancy and equipment	892	817	1,817	1,667

State and local taxes	224	238	456	451
Professional fees	381	228	690	443
Advertising	147	155	277	255
FDIC insurance	317	697	620	928
Merger related costs	0	0	0	453
Intangible amortization	145	148	290	148
Core processing charges	237	13	476	32
Other operating expenses	1,203	1,429	2,475	2,584
TOTAL NONINTEREST EXPENSES	7,645	7,803	15,177	14,059
INCOME BEFORE INCOME TAXES	2,652	2,018	3,492	4,113
INCOME TAXES	618	361	611	772
NET INCOME	$ 2,034	$ 1,657	$ 2,881	$ 3,341
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Change in net unrealized gains (losses) on securities, net of reclassifications	2,988	(944)	4,055	(152)
COMPREHENSIVE INCOME (LOSS)	$ 5,022	$ 713	$ 6,936	$ 3,189
NET INCOME PER SHARE basic and diluted	$ 0.15	$ 0.12	$ 0.21	$ 0.25
DIVIDENDS PER SHARE	$ 0.03	$ 0.12	$ 0.06	$ 0.24

See accompanying notes

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

	(In Thousands of Dollars) Six Months Ended June 30, 2010	June 30, 2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,881	$ 3,341
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	4,378	1,500
Depreciation and amortization	861	671
Net amortization of securities	504	170
Security gains (losses)	3	(509)
Impairment of securities	0	74
Loss on sale of other real estate owned	48	0
Increase in bank owned life insurance	(257)	(257)
Net change in other assets and liabilities	863	22
NET CASH FROM OPERATING ACTIVITIES	9,281	5,012
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and repayments of securities available for sale	27,489	37,874
Proceeds from sales of securities available for sale	1,896	9,530
Purchases of securities available for sale	(39,014)	(55,535)
Purchase of trust entity, net	0	(10,511)
Loan originations and payments, net	(7,560)	(42,240)
Proceeds from sale of other real estate owned	354	146
Additions to premises and equipment	(632)	(395)
NET CASH FROM INVESTING ACTIVITIES	(17,467)	(61,131)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in deposits	(16,873)	65,606
Net change in short-term borrowings	11,999	12,403
Repayments of Federal Home Loan Bank borrowings and other debt	(1,889)	(2,409)
Cash dividends paid	(813)	(3,189)
Proceeds from dividend reinvestment	240	946
NET CASH FROM FINANCING ACTIVITIES	(7,336)	73,357
NET CHANGE IN CASH AND CASH EQUIVALENTS	(15,522)	17,238
Beginning cash and cash equivalents	51,160	24,049
Ending cash and cash equivalents	$ 35,638	$ 41,287

Supplemental cash flow information:				
Interest paid	$	6,435	$	8,473
Income taxes paid	$	50	$	1,165
Supplemental noncash disclosures:				
Transfer of loans to other real estate	$	173	$	436

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 were as follows:

Fair value of assets acquired	$	12,394
Purchase price		12,125
Liabilities assumed	$	269

See accompanying notes

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Principles of Consolidation:

The consolidated financial statements include the accounts of Farmers National Banc Corp. (the Company) and its wholly-owned subsidiaries, The Farmers National Bank of Canfield, Farmers Trust Company and Farmers National Insurance. 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 2009 Annual Report to Shareholders included in the Company s 2009 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. 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, carrying amount of goodwill and fair values of financial instruments are 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 primarily aggregated and reported in two lines of business, the Bank segment and the Trust segment.

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Securities:

The following table summarizes the amortized cost and fair value of the available-for-sale investment securities portfolio at June 30, 2010 and December 31, 2009 and the corresponding amounts of unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

(In Thousands of Dollars) **June 30, 2010**	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and U.S. government-sponsored entities	$ 131,019	$ 4,521	$ (8)	$ 135,532
States and political subdivisions	61,046	1,574	(273)	62,347
Mortgage-backed securities residential	120,681	5,494	(10)	126,165
Collateralized mortgage obligations	154	3	0	157
Equity securities	149	78	(15)	212
Other securities	250	18	0	268
Totals	$ 313,299	$ 11,688	$ (306)	$ 324,681

(In Thousands of Dollars) **December 31, 2009**				
U.S. Treasury and U.S. government-sponsored entities	$ 98,746	$ 1,424	$ (337)	$ 99,833
States and political subdivisions	62,809	1,070	(447)	63,432
Mortgage-backed securities residential	141,915	3,758	(411)	145,262
Collateralized mortgage obligations	309	9	0	318
Equity securities	149	129	(19)	259
Other securities	250	14	0	264
Totals	$ 304,178	$ 6,404	$ (1,214)	$ 309,368

Proceeds from sales of securities were $1.90 million for the three and six month periods ending June 30, 2010. Proceeds of $9.53 million were recognized for the three and six month periods ended June 30, 2009. Gross losses of $3 thousand and gross gains of $509 thousand were realized during the second quarter on these sales during 2010 and 2009, respectively.

The amortized cost and fair value of the debt securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if issuers have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage backed securities are not due at a single maturity date and are shown separately.

(In Thousands of Dollars)	June 30, 2010	
Maturity	Amortized Cost	Fair Value
Within one year	$ 3,494	$ 3,520
One to five years	119,075	122,456
Five to ten years	39,994	41,381
Beyond ten years	29,752	30,790
Mortgage-backed and CMO securities	120,835	126,322

Total	$	313,150	$	324,469

(In Thousands of Dollars)	December 31, 2009	
Maturity	Amortized Cost	Fair Value
Within one year	$ 3,538	$ 3,563
One to five years	92,162	93,357
Five to ten years	35,177	35,777
Beyond ten years	30,928	30,832
Mortgage-backed and CMO securities	142,224	145,580
Total	$ 304,029	$ 309,109

The following table summarizes the investment securities with unrealized losses at June 30, 2010 and December 31, 2009 aggregated by major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
(In Thousands of Dollars)	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
June 30, 2010	Value	Losses	Value	Losses	Value	Losses
Available-for-sale						
U.S. Treasury and U.S. government-sponsored entities	$ 2,071	$ (1)	$ 335	$ (7)	$ 2,406	$ (8)
States and political subdivisions	4,134	(29)	3,937	(244)	8,071	(273)
Mortgage-backed securities residential	2,060	(9)	28	(1)	2,088	(10)
Equity securities	0	0	8	(15)	8	(15)
Total	$ 8,265	$ (39)	$ 4,308	$ (267)	$ 12,573	$ (306)
(In Thousands of Dollars)						
December 31, 2009						
Available-for-sale						
U.S. Treasury and U.S. government-sponsored entities	$ 44,854	$ (330)	$ 359	$ (7)	$ 45,213	$ (337)
States and political subdivisions	13,336	(162)	3,035	(285)	16,371	(447)
Mortgage-backed securities residential	40,304	(410)	60	(1)	40,364	(411)
Equity securities	28	(3)	7	(16)	35	(19)
Total	$ 98,522	$ (905)	$ 3,461	$ (309)	$ 101,983	$ (1,214)

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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 Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320, *Investments 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, whether the market decline was affected by macroeconomic conditions and whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In analyzing an issuer s financial condition, the Company 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.

As of June 30, 2010, the Company s security portfolio consisted of 428 securities, 38 of which were in an unrealized loss position. The majority of the unrealized losses on the Company s securities are related to its holdings of U.S. Government-sponsored entities, state and political subdivisions, and mortgage-backed securities as discussed below.

Unrealized losses on debt securities issued by U.S. Government-sponsored entities have not been recognized into income because the securities are of high credit quality, management does not have the intent to sell these securities before their anticipated recovery and the decline in fair value is largely due to fluctuations in market interest rates and not credit quality. The fair value is expected to recover as the securities approach their maturity date.

Unrealized losses on debt securities at June 30, 2010 related to obligations of state and political subdivisions have not been recognized into income. Generally these securities have maintained their investment grade ratings and management does not have the intent to sell these securities before their anticipated recovery which may be at maturity.

All of the Company s holdings of mortgage-backed securities were issued by U.S. Government sponsored enterprises. Unrealized losses on mortgage-backed securities have not been recognized into income. Because the decline in fair value of these mortgage-backed securities is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired.

Loans:

Loan balances were as follows:

(In Thousands of Dollars)	June 30, 2010	December 31, 2009
Residential real estate	$ 181,551	$ 180,877
Commercial real estate	213,251	215,917
Consumer	135,663	136,708
Commercial	82,794	75,893
Subtotal	613,259	609,395
Allowance for loan losses	(8,255)	(7,400)

Net loans	$ 605,004	$ 601,995

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Activity in the allowance for loan losses was as follows:

(In Thousands of Dollars)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Balance at beginning of period	$ 8,220	$ 5,835	$ 7,400	$ 5,553
Provision for loan losses	1,600	1,050	4,378	1,500
Recoveries	125	248	272	378
Loans charged off	(1,690)	(493)	(3,795)	(791)
Balance at end of period	$ 8,255	$ 6,640	$ 8,255	$ 6,640

Individually impaired loans were as follows:

(In Thousands of Dollars)	June 30, 2010	December 31, 2009
Loans with no allocated allowance for loan losses	$ 2,240	$ 425
Loans with allocated allowance for loan losses	7,569	13,071
	$ 9,809	$ 13,496
Amount of the allowance for loan losses allocated	$ 1,644	$ 2,058

Impaired loans decreased during the first six months of 2010 due to loan charge-offs and the sale of collateral associated with the impaired loans. In addition to the charge-off activity there were relationships that were classified as nonperforming troubled debt restructurings at December 31, 2009 that have been performing in accordance with their new contractual terms and, as a result, have been removed from this category at June 30, 2010.

Included in the $9.81 million disclosed above at June 30, 2010 are $3.03 million of loans that have terms that have been modified under troubled debt restructuring. The Company has allocated $40 thousand of specific reserves to those loans at June 30, 2010. At December 31, 2009, $5.44 million of loans have terms have been modified under troubled debt restructuring are included in the $13.50 million of individually impaired loans. The Company has allocated $333 thousand of specific reserves to those loans at December 31, 2009.

Interest income recognized during impairment for the periods was immaterial.

Nonperforming loans were as follows:

(In Thousands of Dollars)	June 30, 2010	December 31, 2009
Nonaccrual loans:		
Residential real estate	$ 2,880	$ 2,281
Commercial real estate	4,630	5,677
Consumer	142	172
Commercial	2,151	1,504
Total Nonaccrual Loans	9,803	9,634
Loans past due over 90 days still on accrual	151	469
Total nonperforming loans	$ 9,954	$ 10,103
Other real estate owned	145	374

Total nonperforming assets	$ 10,099	$ 10,477
Percentage of nonperforming loans to gross loans	1.62%	1.66%
Percentage of nonperforming assets to total assets	1.00%	1.03%
Loans delinquent 30-90 days	5,652	9,212
Percentage of loans delinquent 30-90 days to total loans	.92%	1.51%

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

(In Thousands, except Share and Per Share Data)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Basic EPS computation				
Numerator Net income	$ 2,034	$ 1,657	$ 2,881	$ 3,341
Denominator Weighted average shares outstanding	13,546,569	13,339,289	13,533,302	13,285,768
Basic earnings per share	$ .15	$ .12	$ .21	$ .25
Diluted EPS computation				
Numerator Net income	$ 2,034	$ 1,657	$ 2,881	$ 3,341
Denominator Weighted average shares outstanding for basic earnings per share	13,546,569	13,339,289	13,533,302	13,285,768
Effect of Stock Options	0	0	0	0
Weighted averages shares for diluted earnings per share	13,546,569	13,339,289	13,533,302	13,285,768
Diluted earnings per share	$ .15	$ .12	$ .21	$ .25

Stock options for 34,000 and 42,000 shares were not considered in the computing of diluted earnings per share for 2010 and 2009, respectively, because they were antidilutive.

Stock Based Compensation:
The Company s Stock Option Plan (the Plan) permitted the grant of share options to its directors, officers and employees. Under the terms of the Plan no additional shares can be issued. Option awards were granted with an exercise price equal to the market price of the Company s common stock at the date of grant and such option awards have vesting periods of 5 years and have 10-year contractual terms. At June 30, 2010 there were 34,000 outstanding options of which 30,000 are fully vested and are 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 three month and six month period ended June 30, 2010 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.

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Recent Accounting Pronouncements

In June 2009, FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140.* This removes the concept of a qualifying special-purpose entity from existing GAAP and removes the exception from applying FASB ASC 810-10, *Consolidation* (FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities) to qualifying special purpose entities. The objective of this new guidance 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 (which includes loan participations); the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement in transferred financial assets. The Company s adoption of this new guidance on January 1, 2010, did not have a material impact on the Company s consolidated financial statements.

In June 2009, FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (ASC 810). The objective of this new guidance 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. The Company s adoption of this new guidance on January 1, 2010 had no impact on the Company s consolidated financial statements.

In January 2010, the FASB issued an amendment to Fair Value Measurements and Disclosures, Topic 820, *Improving Disclosures About Fair Value Measurements*. This amendment requires new disclosures regarding significant transfers in and out of Level 1 and 2 fair value measurements and the reasons for the transfers. This amendment also requires that a reporting entity present separately information about purchases, sales, issuances and settlements, on a gross basis rather than a net basis for activity in Level 3 fair value measurements using significant unobservable inputs. This amendment also clarifies existing disclosures on the level of disaggregation, in that the reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities, and that a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for Level 2 and 3. The new disclosures and clarifications of existing disclosures for ASC 820 are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of ASC 820 did not have a material effect on the Company s consolidated financial statements.

Fair Value

Fair value is 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. There are 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 an asset or liability.

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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).

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 usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

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, 2010 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Investment securities available-for sale				
U.S. Treasury and U.S. Government sponsored entities	$ 135,532	$ 0	$ 135,532	$ 0
States and political subdivisions	62,347	0	62,347	0
Mortgage-backed securities-residential	126,165	0	126,152	13
Collateralized mortgage obligations	157	0	157	0
Equity securities	212	212	0	0
Other securities	268	0	268	0
Total investment securities	$ 324,681	$ 212	$ 324,456	$ 13

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(In Thousands of Dollars)	Carrying Value	Fair Value Measurements at December 31, 2009 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Investment securities available-for sale				
(U.S. Treasury and U.S. Government sponsored entities	$ 99,833	$ 0	$ 99,833	$ 0
States and political subdivisions	63,432	0	63,432	0
Mortgage-backed securities-residential	145,262	0	145,249	13
Collateralized mortgage obligations	318	0	318	0
Equity securities	259	259	0	0
Other securities	264	0	264	0
Total investment securities	$ 309,368	$ 259	$ 309,096	$ 13

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis:

	Investment Securities Available-for-sale (Level 3) Three months ended June 30, 2010	Six months ended June 30, 2010
Beginning balance	$ 13	$ 13
Total unrealized gains or losses:		
Included in other comprehensive income	0	0
Purchases, sales, issuances and settlements, net	0	0
Transfer in and/or out	0	0
Ending balance	$ 13	$ 13

Assets and Liabilities Measured on a Non-Recurring Basis

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

Fair Value Measurements at June 30, 2010 Using Significant

(In Thousands of Dollars)	Quotes Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Impaired loans	$ 0	$ 0	$ 4,134

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(In Thousands of Dollars)	Fair Value Measurements at December 31, 2009 Using Quotes Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Impaired loans	$ 0	$ 0	$ 5,904

The following represent impairment charges recognized during the period:

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $5.74 million with a valuation allowance of $1.60 million, resulting in an additional provision for loan loss of $1.92 million for the six month period ending June 30, 2010. At December 31, 2009, impaired loans had a carrying amount of $6.33 million, net of a valuation allowance of $1.73 million, resulting in an additional provision for loan losses of $1.50 million for the year ending December 31, 2009.

The carrying amounts and estimated fair values of financial instruments, at June 30, 2010 and December 31, 2009 are as follows:

(In Thousands of Dollars) **June 30, 2010**	Carrying Amount	Fair Value
Financial assets		
Cash and cash equivalents	$ 35,638	$ 35,638
Securities available-for-sale	324,681	324,681
Restricted stock	3,977	n/a
Loans, net	605,004	615,089
Accrued interest receivable	4,405	4,405
Financial liabilities		
Deposits	760,679	764,542
Short-term borrowings	137,911	137,911
Long-term borrowings	25,280	27,853
Accrued interest payable	955	955

(In Thousands of Dollars) **December 31, 2009**	Carrying Amount	Fair Value
Financial assets		
Cash and cash equivalents	$ 51,160	$ 51,160
Securities available-for-sale	309,368	309,368
Restricted stock	3,977	n/a
Loans, net	601,995	609,127
Accrued interest receivable	4,370	4,370
Financial liabilities		
Deposits	777,552	781,703
Short-term borrowings	125,912	125,912
Long-term borrowings	27,169	28,990

Accrued interest payable	1,155	1,155

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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.

Segment Information

A reportable segment is determined by the products and services offered, primarily distinguished between banking and trust operations. They are also distinguished by the level of information provided to the chief operating decision makers in the Company, who use such information to review performance of various components of the business, which are then aggregated. Loans, investments, and deposits provide the revenues in the banking operation, and trust service fees provide the revenue in trust operations. All operations are domestic.
Significant segment totals are reconciled to the financial statements as follows:

(In Thousands of Dollars) **June 30, 2010**	**Trust Segment**	**Bank Segment**	**Others**	**Consolidated Totals**
Assets				
Cash and due from banks	$ 750	$ 34,982	$ (94)	$ 35,638
Securities available for sale	2,738	321,811	132	324,681
Net loans	0	605,004	0	605,004
Premises and equipment, net	123	14,181	0	14,304
Goodwill	3,709	0	0	3,709
Other intangibles	3,501	0	0	3,501
Other assets	539	27,062	366	27,967
Total Assets	$ 11,360	$ 1,003,040	$ 404	$ 1,014,804
Liabilities and Stockholders Equity				
Deposits, borrowings and other liabilities	$ 682	$ 927,805	$ (674)	$ 927,813
Stockholders equity	10,678	75,235	1,078	86,991
Total Liabilities and Stockholders Equity	$ 11,360	$ 1,003,040	$ 404	$ 1,014,804

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(In Thousands of Dollars)

For the Three Months ended June 30, 2010	**Trust Segment**	**Bank Segment**	**Others**	**Consolidated Totals**
Interest and dividend income	$ 20	$ 12,079	$ 0	$ 12,099
Interest expense	0	2,911	12	2,923
Net interest income	20	9,168	(12)	9,176
Provision for loan losses	0	1,600	0	1,600