

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, 2003 Commission file number 2-80339

FARMERS NATIONAL BANC CORP.
(Exact name of registrant as specified in its charter)

OHIO

34-1371693

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No)

20 South Broad Street
Canfield, OH 44406

44406

(Address of principal executive offices)

(Zip Code)

(330) 533-3341

(Registrant's telephone number, including area code)

Not applicable

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

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

Yes No

Indicate by check mark whether the registrant is an accelerated filer (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.

| <u>Class</u> | <u>Outstanding at July 31, 2003</u> |
|----------------------------|-------------------------------------|
| Common Stock, No Par Value | 12,419,562 shares |

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See accompanying notes to consolidated financial statements

CONSOLIDATED BALANCE SHEETS
FARMERS NATIONAL BANC CORP. AND SUBSIDIARY

(Unaudited)

| | (In Thousands of Dollars) | |
|---|---------------------------|----------------------|
| | June 30, 2003 | December 31, 2002 |
| ASSETS | | |
| Cash and due from banks | \$ 30,274 | \$ 31,204 |
| Federal funds sold | 4,438 | 4,537 |
| | <u>34,712</u> | <u>35,741</u> |
| TOTAL CASH AND CASH EQUIVALENTS | 34,712 | 35,741 |
| Securities available for sale | 288,213 | 251,089 |
| Loans | 462,342 | 449,693 |
| Less allowance for credit losses | 6,900 | 6,779 |
| | <u>455,442</u> | <u>442,914</u> |
| NET LOANS | 455,442 | 442,914 |
| Premises and equipment, net | 14,329 | 12,892 |
| Other assets | 5,803 | 5,462 |
| | <u>\$798,499</u> | <u>\$748,098</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits (all domestic): | | |
| Noninterest-bearing | \$ 51,713 | \$ 51,001 |
| Interest-bearing | 553,007 | 537,253 |
| | <u>604,720</u> | <u>588,254</u> |
| TOTAL DEPOSITS | 604,720 | 588,254 |
| U. S. Treasury interest-bearing demand note | 791 | 810 |
| Securities sold under repurchase agreements | 82,701 | 51,117 |
| Federal Home Loan Bank advances | 22,990 | 23,022 |
| Other liabilities and deferred credits | 4,322 | 3,943 |
| | <u>715,524</u> | <u>667,146</u> |
| TOTAL LIABILITIES | 715,524 | 667,146 |
| Stockholders' Equity: | | |
| Common Stock — Authorized 25,000,000 shares; issued 12,995,880 in 2003 and 12,854,352 in 2002 | 64,879 | 62,631 |
| Retained earnings | 19,313 | 18,404 |
| Accumulated other comprehensive income | 5,484 | 4,887 |
| Treasury stock, at cost; 529,818 shares in 2003 and 418,774 in 2002 | (6,701) | (4,970) |
| | <u>82,975</u> | <u>80,952</u> |
| TOTAL STOCKHOLDERS' EQUITY | 82,975 | 80,952 |
| | <u>\$798,499</u> | <u>\$748,098</u> |

See accompanying notes to consolidated financial statements

**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
FARMERS NATIONAL BANC CORP. AND SUBSIDIARY**

(Unaudited)

| | (In Thousands except Per Share Data) | | | |
|--|--------------------------------------|------------------|--------------------------|------------------|
| | For the Three Months Ended | | For the Six Months Ended | |
| | June 30, 2003 | June 30, 2002 | June 30, 2003 | June 30, 2002 |
| INTEREST INCOME | | | | |
| Interest and fees on loans | \$ 8,285 | \$ 8,722 | \$16,517 | \$17,353 |
| Interest and dividends on securities: | | | | |
| Taxable interest | 2,160 | 1,482 | 4,241 | 2,774 |
| Nontaxable interest | 418 | 359 | 827 | 710 |
| Dividends | 161 | 173 | 320 | 377 |
| Interest on federal funds sold | 64 | 200 | 106 | 388 |
| TOTAL INTEREST INCOME | 11,088 | 10,936 | 22,011 | 21,602 |
| INTEREST EXPENSE | | | | |
| Deposits | 2,770 | 3,760 | 5,772 | 7,561 |
| Borrowings | 883 | 792 | 1,595 | 1,602 |
| TOTAL INTEREST EXPENSE | 3,653 | 4,552 | 7,367 | 9,163 |
| NET INTEREST INCOME | 7,435 | 6,384 | 14,644 | 12,439 |
| Provision for credit losses | 200 | 270 | 470 | 540 |
| NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES | 7,235 | 6,114 | 14,174 | 11,899 |
| OTHER INCOME | | | | |
| Service charges on deposit accounts | 485 | 436 | 938 | 880 |
| Investment security gains | 0 | 117 | 0 | 153 |
| Other operating income | 264 | 248 | 519 | 541 |
| TOTAL OTHER INCOME | 749 | 801 | 1,457 | 1,574 |
| OTHER EXPENSES | | | | |
| Salaries and employee benefits | 2,655 | 2,369 | 5,218 | 4,729 |
| Net occupancy expense of premises | 254 | 264 | 543 | 529 |
| Furniture and equipment expense, including depreciation | 297 | 299 | 593 | 624 |
| State and local taxes | 218 | 211 | 437 | 410 |
| Other operating expenses | 1,116 | 1,225 | 2,276 | 2,398 |
| TOTAL OTHER EXPENSES | 4,540 | 4,368 | 9,067 | 8,690 |
| INCOME BEFORE FEDERAL INCOME TAXES | 3,444 | 2,547 | 6,564 | 4,783 |
| FEDERAL INCOME TAXES | 1,021 | 735 | 1,935 | 1,368 |
| NET INCOME | \$ 2,423 | \$ 1,812 | \$ 4,629 | \$ 3,415 |
| OTHER COMPREHENSIVE INCOME, NET OF TAX: | | | | |
| Change in net unrealized gains on securities, net of reclassifications | 846 | 1,353 | 597 | 858 |
| COMPREHENSIVE INCOME | \$ 3,269 | \$ 3,165 | \$ 5,226 | \$ 4,273 |
| NET INCOME PER SHARE-basic and diluted | \$ 0.19 | \$ 0.15 | \$ 0.37 | \$ 0.28 |
| DIVIDENDS PER SHARE | \$ 0.15 | \$ 0.14 | \$ 0.30 | \$ 0.28 |

See accompanying notes to consolidated financial statements

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

(Unaudited)

(In Thousands of Dollars)

| | Six Months Ended | |
|--|------------------|-----------------|
| | June 30, 2003 | June 30 2002 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | \$ 6,819 | \$ 4,598 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from maturities and repayments of securities available for sale | 27,414 | 14,206 |
| Proceeds from sales of securities available for sale | 0 | 1,411 |
| Purchases of securities available for sale | (64,529) | (62,109) |
| Net increase in loans made to customers | (13,605) | (14,804) |
| Purchases of premises and equipment | (1,891) | (422) |
| NET CASH USED IN INVESTING ACTIVITIES | (52,611) | (61,718) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net increase in deposits | 16,554 | 32,122 |
| Net increase in short-term borrowings | 31,533 | 10,597 |
| Proceeds from Federal Home Loan Bank borrowings | 2,500 | 4,460 |
| Repayment of Federal Home Loan Bank borrowings | (2,532) | (6,408) |
| Purchase of Treasury Stock | (1,731) | (1,675) |
| Dividends paid | (3,809) | (3,419) |
| Proceeds from sale of common stock | 2,248 | 1,911 |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 44,763 | 37,588 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,029) | (19,532) |
| CASH AND CASH EQUIVALENTS | | |
| Beginning of period | 35,741 | 65,413 |
| End of period | \$ 34,712 | \$ 45,881 |
| SUPPLEMENTAL DISCLOSURES | | |
| Interest paid | (7,344) | (9,605) |
| Income taxes paid | (2,072) | (789) |

See accompanying notes to consolidated financial statements

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Principals of Consolidation:

The consolidated financial statements include the accounts of the company and its wholly-owned subsidiary, The Farmers National Bank of Canfield. All significant intercompany balances and transactions have been eliminated.

Basis of Presentation:

The unaudited condensed consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("U.S. GAAP"), for complete financial statements. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2002 Annual Report to Shareholders included in the Company's 2002 Annual Report on Form 10-K. The interim condensed consolidated financial statements include all adjustments (consisting of only normal recurring items) that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year.

Estimates:

To prepare financial statements in conformity with U.S. GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for credit losses and fair values of certain securities 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 evaluated on a Company-wide basis. Accordingly, all the Company's banking operations are considered by management to be aggregated in one reportable operating segment.

Stock-Based Compensation:

Employee compensation expense under stock options is reported using the intrinsic valuation method. No stock-based compensation cost is reflected in net income, as all options granted had an exercise price equal to or greater than the market price of the underlying common stock at the date of grant. The following table illustrates the effect on net income and earnings per share if expense was measured using the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock Based Compensation.

Notes to Unaudited Consolidated Financial Statements (continued)

| (In Thousands, except Per Share Data) | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|---------|------------------------------|---------|
| | 2003 | 2002 | 2003 | 2002 |
| Net income, as reported | \$2,423 | \$1,812 | \$4,629 | \$3,415 |
| Less: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net or related tax effects | (5) | (5) | (10) | (10) |
| Pro forma net income | \$2,418 | \$1,807 | \$4,619 | \$3,405 |
| Earnings per share: | | | | |
| As reported | \$.19 | \$.15 | \$.37 | \$.28 |
| Pro forma | \$.19 | \$.15 | \$.37 | \$.28 |

Earnings Per Share:

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

| (In Thousands, except Per Share Data) | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|------------|------------------------------|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Basic EPS computation | | | | |
| Numerator — Net income | \$ 2,423 | \$ 1,812 | \$ 4,629 | \$ 3,415 |
| Denominator — Weighted average shares outstanding | 12,428,644 | 12,332,916 | 12,417,325 | 12,327,434 |
| Basic earnings per share | \$.19 | \$.15 | \$.37 | \$.28 |
| Diluted EPS computation | | | | |
| Numerator — Net income | \$ 2,423 | \$ 1,812 | \$ 4,629 | \$ 3,415 |
| Denominator — Weighted average shares outstanding for basic earnings per share | 12,428,644 | 12,332,916 | 12,417,325 | 12,327,434 |
| Effect of Stock Options | 17,136 | 2,154 | 15,891 | 1,989 |
| Weighted averages shares for diluted earnings per share | 12,445,780 | 12,335,070 | 12,433,216 | 12,329,423 |
| Diluted earnings per share | \$.19 | \$.15 | \$.37 | \$.28 |

Per share information has been restated to reflect the impact of stock dividends.

Comprehensive Income:

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income consists solely of unrealized gains and losses on securities available for sale. The following table discloses the reclassification of available for sale security gains and losses.

| (In Thousands of Dollars) | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|----------------|------------------------------|--------------|
| | 2003 | 2002 | 2003 | 2002 |
| Net unrealized holding gains on available for sale securities arising during the period, net of tax | \$846 | \$1,430 | \$597 | \$959 |
| Less: Reclassification adjustment for net gains realized in net income, net of tax | 0 | 77 | 0 | 101 |
| Net unrealized gains, net of tax | <u>\$846</u> | <u>\$1,353</u> | <u>\$597</u> | <u>\$858</u> |

New Accounting Pronouncements:

On April 30, 2003, the FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" to amend and clarify prior guidance. This guidance clarifies the definition of a derivative, deals with cash flow reporting for derivatives that contain a financing element, clarifies the term required of mirror call or put options in interest rate swaps used in short-cut hedges, and clarifies provisions dealing with "regular way" securities trades and contracts to purchase or sell securities that do not yet exist. The standard is effective prospectively for hedging relationships and contracts entered into or modified after June 30, 2003; however SFAS 149 leaves in place earlier effective dates for matters already settled via the Derivatives Implementation Group process. Management does not expect the effect of adoption of this statement to be material.

In May 2003, the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". According to FASB 150, the following must be classified as liabilities: shares that are mandatorily redeemable, where there is an unconditional obligation of the issuer to redeem it by transferring assets at a specified date or upon an event certain to incur; financial instruments that represent an obligation to repurchase shares that may require the issuer to settle by transferring assets; and financial instruments that are a conditional obligation that may be settled by issuing a variable number of equity shares, if the value at inception is based on a fixed monetary amount or is indexed to something other than the fair value of the equity shares. This Statement does not apply to convertible bonds, puttable stock, or other outstanding shares that are conditionally redeemable. It is effective for financial instruments that are new or modified after May 31, 2003, and to existing financial instruments in the first interim period beginning after June 15, 2003. Management does not expect the effect of adoption of this statement to be material.

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

Forward Looking Statements

The following financial review presents an analysis of the assets and liability structure of the Corporation and a discussion of the results of operations for each of the periods presented in this quarterly report of liquidity, capital and credit quality. Certain statements in this report that relate to Farmers National Banc Corp.'s plans, objectives, or future performance may be deemed to be forward-looking statements within the Private Securities Litigation Reform Act of 1995. Such statements are based on management's current expectations. Actual strategies and results in future periods may differ materially from those currently expected because of various risks and uncertainties.

Among the important factors that could cause actual results to differ materially are interest rates, changes in the mix of the company's business, competitive pressures, general economic conditions and the risk factors detailed in the company's other periodic reports and registration statements filed with the Securities and Exchange Commission.

Results of Operations

Comparison of the Three and Six Months Ended June 30, 2003 and 2002

The Corporation's net income for the first six months of 2003 was \$4.63 million, or \$.37 per share, which is a 35.55% increase compared with the \$3.42 million, or \$.28 per share earned during the same period last year. During the second quarter of 2003, net income was \$2.42 million, or \$.19 per share, which is a 33.72% increase compared with the \$1.81 million, or \$.15 per share earned during the same period last year. The reported increases in net income are primarily attributable to increases in net interest income, as explained in the following paragraph. Return on average assets and return on average equity for the first six months of 2003 were 1.21% and 11.33% respectively, compared to 1.07% and 9.87% for the same period in 2002.

Net Interest Income. Net interest income for the first six months of 2003 totaled \$14.64 million, an increase of \$2.21 million or 17.73% over the first six months of 2002. While interest income increased \$409 thousand or 1.89%, interest expense decreased \$1.80 million or 19.6%. The increase in interest income was attributable to a 14.62% increase in average earning assets. This increase was partially offset by a decrease of 76 basis points in the yield on average earning assets. The growth in average earning assets occurred mainly in the investment portfolio. The decline in interest expense was mainly due to a 101 basis points decrease in the rates paid on deposits, caused by a general decline in interest rates. This drop in deposit rates helped boost our tax equated net interest margin from 4.08% at June 30, 2002 to 4.19% at June 30, 2003.

Net interest income for the quarter ended June 30, 2003 totaled \$7.44 million, an increase of \$1.05 million or 16.46% over the quarter ended June 30, 2002. The majority of the increase in net interest income is attributable to the \$899 thousand decrease or 19.75% in interest expense. Deposit expense decreased \$990 thousand, caused by a general decline in interest rates.

Other Income. Total other income decreased by \$117 thousand or 7.43% from a year ago. This decrease is attributable to a decrease in investment security gains. Investment security gains were \$0 for the first six months of 2003 and \$153 thousand for the same period in 2002.

Total other income for the quarter ended June 30, 2003 decreased by \$52 thousand or 6.49% from the prior year comparable quarter. This decrease is due to a decrease in investment security gains. Investment security gains were \$0 for the quarter ended June 30, 2003 and \$117 thousand for the quarter ended June 30, 2002.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
(continued)

Other Expense. Other expense was \$9.07 million for the first six months of 2003 compared to \$8.69 million for the same time in 2002. This increase of 4.34% mostly occurred in the area of salaries and employee benefits. Salaries and employee benefits increased \$489 thousand or 10.34% due primarily to a substantial increase in employee health insurance costs. These health insurance costs increased \$308 thousand or 49.41%. The efficiency ratio improved to 56.31% for the first six months of 2003 compared to 62.70% for the first six months of 2002. The efficiency ratio is calculated as follows: non-interest expense divided by the sum of net interest income plus non-interest income, excluding security gains. This ratio is a measure of the expense incurred to generate a dollar of revenue. Management will continue to closely monitor and keep the increases in other expenses to a minimum.

Other expense was \$4.54 million for the quarter ended June 30, 2003 compared to \$4.37 million for the same quarter in 2002. This increase of 3.94% occurred mainly in the area of salaries and employee benefits. Salaries and employee benefits increased \$286 thousand or 12.07% primarily due to a substantial increase in employee health insurance costs. Health insurance costs increased \$172 thousand or 51.96% over the prior year comparable quarter.

Income Taxes. Income tax expense totaled \$1.94 million for the first six months of 2003 and \$1.37 million for the first six months of 2002, an increase of 41.45%. The increase in federal income taxes is a result of the substantial increase in net interest income discussed earlier. The effective tax rate for the first six months of 2003 was 29.48% compared to 28.60% for the same time in 2002.

Income tax expense totaled \$1.02 million for the quarter ended June 30, 2003 and \$735 thousand for the quarter ended June 30, 2002, an increase of 38.91%. This increase in federal income taxes is a result of the substantial increase in net interest income discussed earlier.

Financial Condition

Total assets grew \$50.40 million or 6.74% since December 31, 2002. Average earning assets increased \$93.21 million or 14.62% when comparing June 30, 2003 to June 30, 2002. Most of this growth in assets is a direct result of increases in deposit balances and borrowings. Total liabilities increased \$48.38 million or 7.25% since December 31, 2002. Average interest-bearing liabilities increased \$95.32 million or 17.43% from June 30, 2002 to June 30, 2003. Capital ratios remain solid, as shown by the ratio of equity to total assets at June 30, 2003 of 10.39%.

Securities. Securities available for sale grew \$37.12 million or 14.79% since December 31, 2002. In addition, average investments increased \$76.07 million or 38.60% when comparing June 30, 2003 to June 30, 2002. As the interest-bearing liabilities increased, they were primarily invested in high-grade investment securities. Most of this investment occurred in mortgage-backed securities and federal agencies.

Loans. Gross loans increased \$12.65 million or 2.81% since December 31, 2002. Furthermore, average loans increased \$17.14 million or 3.89% from June 30, 2002 to June 30, 2003. Most of this increase from the prior year comparable six month period occurred in the Commercial Real Estate Portfolio.

Allowance for Credit Losses. The allowance for credit losses as a percentage of loans decreased from 1.51% at December 31, 2002 to 1.49% at June 30, 2003. The provision for credit losses for the first six months of 2003 and 2002 was \$470 thousand and \$540 thousand, respectively. Net charge-offs totaled \$349 thousand for the first six months of 2003 down from \$379 thousand for the first six months of 2002. Annualized net charge-offs to average loans for the first six months of 2003 was .15% compared to .17% for the first six months of 2002. Non-performing assets to total loans decreased from .38% as of December 31, 2002 to .29% as of June 30, 2003.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
(continued)

The provision for credit losses charged to operating expense 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 \$16.47 million or 2.80% since December 31, 2002. Average deposits increased \$84.03 million or 16.28% when comparing June 30, 2003 to June 30, 2002. Most of this deposit growth from the prior year comparable six month period occurred in the Company's money market accounts. The Company has continued to offer a competitive rate of interest on money market accounts to attract new customers and enhance existing account relationships.

Borrowings. Total borrowings increased \$31.53 million or 42.07% since December 31, 2002. This increase was a result of repurchase agreements growing \$31.58 million. This growth was caused by the Company offering above market rates on repurchase agreements. Management has since lowered these rates closer to market levels. Management does not expect significant increases in repurchase agreement balances going forward.

Capital Resources. The capital management function is a regular process which consists of providing capital for both the current financial position and the anticipated future growth of the Corporation. As of June 30, 2003 the Corporation's total risk-based capital ratio stood at 17.14%, and the Tier I risk-based capital ratio and Tier I leverage ratio were at 15.88% and 9.71%, respectively. Regulations established by the Federal Deposit Insurance Corporation Improvement Act require that for a bank to be considered well capitalized, it must have a total risk-based capital ratio of 10%, a Tier I risk-based capital ratio of 6% and a Tier I leverage ratio of 5%.

Critical Accounting Policies

The Company follows financial accounting and reporting policies that are in accordance with U.S. GAAP. These policies are presented in Note A to the consolidated audited financial statements in Farmers National Banc Corp.'s 2002 Annual Report to Shareholders included in Farmers National Banc Corp.'s Annual Report on Form 10-K. Critical accounting policies are those policies that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company has identified one accounting policy that is a critical accounting policy and an understanding of this policy is necessary to understand our financial statements. This policy relates to determining the adequacy of the allowance for credit losses. Additional information regarding this policy is included in the section captioned "Allowance for Credit Losses".

Liquidity

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
(continued)

sold, cash and due from banks, as well as cash flows from maturities and repayments of loans, and investment securities.

The primary investing activities of the Company are originating loans and purchasing securities. Net cash used in investing activities amounted to \$52.61 million for the first six months of 2003 compared to \$61.72 million for the same period of 2002. Net increases in loans were \$13.61 million in 2003 compared to \$14.80 million in 2002. Investment purchases, net of investment proceeds from maturities, repayments and sales totaled \$37.12 million for the six month period ended June 30, 2003 and \$46.49 million for the six month period ended June 30, 2002.

The primary financing activities of the Company are obtaining deposits, repurchase agreements and other borrowings. Net cash provided by financing activities amounted to \$44.76 million for the first six months of 2003 and \$37.59 for the same period in 2002. A net increase in deposits provided \$16.55 million in 2003 and \$32.12 million in 2002. In addition, a net increase in short-term borrowings provided \$31.53 million in 2003.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

The Company monitors its exposure to interest rate risk on a quarterly basis through simulation analysis which measures the impact changes in interest rates can have on net income. The simulation technique analyzes the effect of a presumed 100, 200 and 300 basis points shift in interest rates and takes into account prepayment speeds on amortizing financial instruments, loan and deposit volumes and rates, non-maturity deposit assumptions and capital requirements. The results of the simulation indicate that in an environment where interest rates rise or fall 100, 200 or 300 basis points over a 12 month period, using May 31, 2003 amounts as a base case, the Company's change in net interest income would be less than the board mandated limits.

The information required by Item 3 has been disclosed in Item 7A of the Company's Annual Report to Shareholders on Form 10-K for the year ended December 31, 2002. There has been no material change in the disclosure regarding market risk due to the stability of the balance sheet.

Item 4. Controls and Procedures

Based on their evaluation, as of a date within 90 days of the filing of this Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer have concluded the Company's disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934) are effective. There have been no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 2. Changes in Securities

Not applicable.

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 and Reports on Form 8-K

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

2. Not applicable.

3(i) Not applicable.

3(ii) Not applicable.

4. The registrant agrees to furnish to the Commission upon request copies of all instruments not filed herewith defining the rights of holders of long-term debt of the registrant and its subsidiaries.

10. Not applicable.

11. Not applicable.

15. Not applicable.

18. Not applicable.

19. Not applicable.

22. Not applicable.

23. Not applicable.

24. Not applicable.

Item 6. Exhibits and Reports on Form 8- K (continued)

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)

(b) — Reports on Form 8-K

Two Form 8-K's were filed during the second quarter of 2003. The first Form 8-K was dated April 18, 2003 and applied to Item 5, Other Events. This filing reported the earnings for the quarter ended March 31, 2003.

The second Form 8-K was dated May 19, 2003 and also applied to Item 5, Other Events. This filing announced the quarterly dividend.

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 12, 2003

/s/Frank L. Paden

Frank L. Paden
President and Secretary

Dated: August 12, 2003

/s/Carl D. Culp

Carl D. Culp
Executive Vice President
and Treasurer